



**DEPARTMENT OF THE TREASURY**

**INTERNAL REVENUE SERVICE**

**3730 Elizabeth Avenue**

**Independence, MO 64057**

**TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION**

**Release Number: 200743038**

**Date: May 16, 2007**

**Release Date: 10/26/07**

**A = Organization**

**UIL Code: 501.03-01**

**O = Officer**

**Date 1 = Tax Year Ended**

**Date 2 = Specific Date**

**NUM = Employer ID Number**

**Y = Year(s)**

**TA = Taxpayer Advocate Address**

**TAN = Taxpayer Advocate Number**

**Person To Contact:**

**Identification Number:**

**Contact Telephone Number:**

**Form: 990**

**Tax Year Ended: Date 1**

**In Reply Refer to: TE/GE Review Staff**

**EIN: NUM**

**A  
Attn: O**

**LAST DATE FOR FILING A PETITION WITH THE TAX COURT: \_\_\_\_\_**

**Dear :**

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

**Our adverse determination was made for the following reasons:**

**A has not been operating exclusively for exempt purposes within the meaning of I.R.C. §501(c)(3) and Tres. Reg. §1.501(c)(3)-1(d). It is not an organization which operates exclusively for one or more of the exempt purposes which would qualify it as an exempt organization. It has been operating substantially for a non-exempt purpose.**

**Based upon these reasons, we are retroactively revoking A IRC §501(c)(3) tax exempt status for all years beginning on or after Date 2.**

**Contributions to your organization are no longer deductible under IRC §170.**

**A is required to file Form 1120, U.S. Corporation Income Tax Return, for the years ended Date 2 through Y with the appropriate Service Center immediately and by the due date of Form 1120 for all subsequent years. Processing of income tax returns and assessment of any taxes due will not be delayed should a petition for declaratory judgment be filed under §7428.**

**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 Claims Court or the District Court of the United States for the District of Columbia before the 91<sup>st</sup> day after the date that this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment by**

referring to the enclosed Publication 892.

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

You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling TAN or writing to:

Internal Revenue Service  
Taxpayer Advocates Office  
TA

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.

We will notify the appropriate state officials of this action, as required by IRC §6104(c).

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter.

Sincerely,

Lois Lerner  
Director, Exempt Organizations

Enclosure: Publication 892

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

A = Organization  
 B = Bookkeeper  
 C = Company Name  
 D = Directors  
 L = Location  
 P = President  
 X = Specific Description of Activity  
 Y = Year Ended  
 AA = Administrative Assistant  
 AD = Address  
 BA = Bank Name  
 CS = City, State  
 PC = Project Coordinator  
 RA = Registered Agent  
 SN = Specific Name  
 WS = Web site  
 Date 1 =- Specific Date  
 Date 2 = Specific Year  
 Name = Other organizations  
 \* = Dollar amounts  
 ## = Account Number

### **ISSUES**

1. Does the sale of items with X that have been created, promoted, sponsored and sold by the A organization qualify as an educational activity?
2. Are the activities conducted by A exclusively educational or charitable as required for organizations exempt under Internal Revenue Code section 501(c)(3)?
3. Should the exempt status A be revoked if activities found not to be exclusively educational or charitable?

### **FACTS**

The organization was established by Articles of Incorporation filed Date 1 under the name A. The Articles of Incorporation stated that the purpose of the organization as "to receive, administer and expend funds for the charitable and educational purposes in connection with fostering public knowledge and interest in various aspects of the artistic and cultural heritage of the United States, as follows:

1. To establish and maintain for the benefit of the general public an institution devoted to the procurement, care and display of objects of significance in United States Culture.
2. To educate the general public with respect to persons, events or other matters of significance in United States culture.

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

3. To publish and distribute magazines, newsletter and other publications to further the purposes of the corporation.
4. To establish in the main office of the corporation or elsewhere all departments and activities necessary to carry out the purposes of the corporation.
5. To engage in any and all lawful activities incidental to the foregoing purposes except as restricted herein.”

The street address of the initial registered office was AD. The name of the initial registered agent was RA. Membership is limited to organization directors who have no rights or title to property.

The initial directors included D of CS, D and D both from CS. The current President and Executive Director, P, is D’s son-in-law.

The organization received letter 1045 dated Date 1 granting the organization exemption under section 509(a)(1) and 170(b)(1)(A)(vi) under the name A.

No additional documents affiliated with the determination process were available.

At the time of the examination, the organization had 5 employees. Four (4) are full-time and one part-time:

- ✚ President-Executive Director- P
- ✚ Bookkeeper- B
- ✚ Project coordinator- PC
- ✚ Administrative Assistant (FT)- AA
- ✚ Administrative Assistant (PT) – AA

A operates an X located at their web address of WS which sales items that have X. Items may be numbered and carry certificates of authenticity. In addition, the organization sells items that cater to fundraising activities of specified organizations such as the Name, Name, and the Name.

An on-site visit of the organizations facilities reveals the organization is currently leasing office space from D. Space is moderate size which is located in an L. The office space has two office desk in the front area with a few of the reproduced items placed around the office as a part of the office décor ( a chair against a wall, decorative plates on a wall, items on a desk top or placed in the office window). There are 3 individual office spaces and one conference room located in the front areas of the space. In back is a fairly large storage space that houses items the organization sells on-line. These items are packaged on location for delivery when an order is received.

**An account of the organizations activities are described below:**

The board consisted of 4 members: D as Chairman, D as Director (is also the son of D), P as President ( is also D’s Son-in- Law) and D who is a director. The majority of the Board is described as “persons connected in a deep relationship with the Chairman, D”

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

There was no evidence of any Board meetings during the Y tax year examined or any prior or later years, however the President of the organization, P, stated the organization held annual meetings which were usually conducted during family gatherings which may take place during the holidays (i.e. Christmas, Thanksgiving etc...).

Review of the organizations activities revealed the organization maintains an X . The X sells objects that are X. The organization states it "... works on behalf of museums, educational institutions, foundations and other organizations to authorize and market objects that have significant artistic value and authenticity." There were no other activities present as currently being conducted by the organization. Below is a summary of findings;

- Organization has agreements with Name, Name, and Name to issue items of exclusive historical value to those organization members. Organizations named receive a portion of the income from the sale of items designated for their respective organization. List of names are provide to A from organization.
- Other items that are not exclusive to any other organization are posted on the organizations website and/or mailers are sent to collectors who may have purchased similar items from the organization in the past.

The organization submitted to the agent a listing of books that have been sponsored by the A. In addition, a list of speaking engagements conducted by the organization over the years was submitted. Speaking events conducted with dates are listed as radio interview and talk show, National Television- C-Span, numerous newspaper and magazine articles. Even though the organization is identifying these activities as educational, the dates show many of the events as only one such event for the year with the exception of Date 2 as this is the year the "SN" bronze statute debuted. In this year the speaking engagement activities increased. There have been no other speaking engagements listed since. Other than dates and titles, there was no information given as to the purpose or cause for invitation of these speaking engagements or the content.

#### Review of organizations books and records

Review of the organizations books and records reveal the organization's income for the year examined was comprised primarily of the net proceeds resulting from the X. For the year under review the organization's income from X were \$\* of which \$\* was expensed for cost of goods sold.

Review of the organizations prior year returns revealed the organizations income from the same source of sales. In addition, the organization has been operating in the deficit for the past seven (7) years. The reason for this as identified by the agent has been due to several loans the organization has received from the chairperson of the organization, D. Several notes payable totaling \$\* was entered on the General Ledger for tax year Y to record an advance on the SN statues being sold on the organizations web site. The notes payable are due to D who is also the chairperson of the organization. In addition there are other outstanding advances from prior year which totaled \$\*. With interest accruing at 8% per year the total now stands at over \$\*. There has been minimal attempt to repay the notes.

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

In addition, to the large amounts owed to D for notes payable, the organization is currently renting space from D in which there are past rental payments due him in the amount of \$\*.

The review of disbursements from the BA account # ## found the majority of the organizations payments were made to the C for their fees in fulfilling mail orders for the SN and SN. The second largest expense of the organization is for salaries. There were no expenses listed regarding educational or charitable activities.

**LAW**

Section 501(a) of the Internal Revenue Code provides that an organization described in section 501(c) (3) is exempt from income tax. Section 501(c)(3) of the Code exempts from federal income tax corporations organized and operated exclusively for charitable, educational, and other purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual. The term charitable includes relief of the poor and distressed. Section 1.501(c) (3)-1(d) (2), Income Tax Regulations.

The term educational includes (a) instruction or training of the individual for the purpose of improving or developing his capabilities and (b) instruction of the public on subjects useful to the individual and beneficial to the community. Treas. Reg. § 1.501(c)(3)-1(d)(3). In other words, the two components of education are public education and individual training.

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

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that 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. The existence of a substantial nonexempt purpose, regardless of the number or importance of exempt purposes, will cause failure of the operational test. Better Business Bureau of Washington, D.C. v. U.S., 326 U.S. 279 (1945).

Educational purposes include instruction or training of the individual for the purpose of improving or developing his capabilities and instruction of the public on useful and beneficial subjects. Treas. Reg. § 1.501(c)(3)-1(d)(3). In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purposes, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. The Court found that the trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university.

Similarly, in American Institute for Economic Research v. United States, 302 F.2d 934 (Ct. Cl. 1962), the Court considered the status of an organization that provided analyses of securities and

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

industries and of the economic climate in general. The organization sold subscriptions to various periodicals and services providing advice for purchases of individual securities. Although the court noted that education is a broad concept, and assumed for the sake of argument that the organization had an educational purpose, it held that the organization had a significant non-exempt commercial purposes that was not incidental to the educational purpose and was not entitled to be regarded as exempt.

Section 511(a) of the code subjects organizations described in section 501(c) to a tax on their 'unrelated business income' as defined in section 512.

Section 512(a) of the code provides that the term "unrelated business income" means the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business.

Section 513(a) of the code states that the term "unrelated trade or business" means any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501(c).

Section 1.512(a)-1(a) of the Income Tax Regulations (the "Regulations") defines the term "unrelated business taxable income" as the gross income derived from any unrelated trade or business regularly carried, less those deductions allowed by chapter 1 of the code which are directly connected with the carrying on of such trade or business. To be deductible in computing unrelated business taxable income, therefore, expenses, depreciation, and similar items not only must qualify as deductions allowed by chapter 1 of the code, but also must be directly connected with the carrying on of unrelated trade or business. To be "directly connected with" the conduct of unrelated trade or business for purposes of section 512, an item must have proximate and primary relationship to the carrying on of that business.

Section 1.512(a)-1(b) of the regulations provides, in pertinent part, that expenses attributable solely to unrelated business activities are approximately and primarily related to that business activity, and therefore qualify for deduction to the extent that they meet the requirements of section 162, or other relevant provisions of the code. However, where facilities are used both to carry on exempt activities and to conduct unrelated trade or business activities, expenses and similar items attributable to such personnel shall be allocated between the two uses on a reasonable basis.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is "substantially related" to an organization's exempt purposes when the business activity has a substantial causal relationship to the achievement of the exempt purposes for which such organization was formed.

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

Section 1.513-1(d)(3) of the regulations provides that in determining whether activities contribute importantly to the accomplishment of exempt purposes, the size and extent of the activities involved must be considered in relation to the nature and extent of the exempt function that they purport to serve. Thus, where income is realized by an exempt organization from activities that are in part related to the performance of its exempt function, but which are conducted on a larger scale than is reasonably necessary for performance of such functions, the gross income attributable to that portion of the activities in excess of the needs of exempt functions constitutes gross income from the conduct of unrelated trade or business. Such income is not derived from the production or distribution of goods or the performance of services which contribute importantly to the accomplishment of any exempt purpose of the organization.

Rev. Rul. 73-104, 1973-1 C.B 263, indicates that if the nature of items being sold relates specifically to the educational purposes of the museum in which they are sold, sales of such items will be deemed to contribute importantly to the achievement of the museum's exempt purposes. In this revenue ruling, an art museum sold greeting cards with reproductions of objects in its collection printed on them. The revenue ruling notes that the proportions of the reproductions are determined by the form of the original work, and care is taken concerning other technical aspects of the reproduction process. Each card is imprinted with the name of the artist, the title or subject matter of the work, the date or period of its creation and the museum's name. The revenue ruling holds that the sales are related to the exempt purposes of the art museum because the sale of art reproductions stimulates and enhances public awareness, interest and appreciation of art.

**GOVERNMENT POSITION**

The Code allows for a museum to be exempt as an educational organization on the basis of its ownership, maintenance, and exhibition for public viewing of a collection. The sale and rental of reproductions of works from the museum's own collection and reproductions of works not owned by the museum contribute importantly to the achievement of the museum's exempt educational purpose by making items relative to the museum's purpose familiar to a broader segment of the public, thereby enhancing the public's understanding and appreciation of the history of the item. The same is true with respect to literature relating to the items.

Based on information obtained during the examination, it was determined that the primary activity of A was not "educational" or "charitable" as defined under the Internal Revenue Code, its Regulations, or legal precedence. The primary activity was X. This determination was made based on a review of all the activities that A conducted and the manner in which they were conducted. These factors together demonstrate that A's operations were not consistent with section 501(c)(3) of the Code.

Every form of advertising or marketing technique used by A exclusively promoted the availability of its reproductive items and the benefit of the items use for fundraisers. A used targeted mail lists purchased from a list provider and names of prior customers as their base for sending advertisements advocating the sale or availability of products. Any "educational" information provided was truly incidental. Under section 501(c)(3) of the Code, the term "educational" includes "The instruction of the public on subjects useful to the individual and beneficial to the community." In A's case, however, its



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

advertisements/flyers and information included with the products lack information in nature of which would provide enough educational information on its subjects beyond a summary of the subjects significance in X. The website appears to be very similar to that of WS and WS which are both companies that provide X (WS however provides more historic details/information). A's advertisements served a commercial purpose and were being used as a marketing tool to sell products.

In addition, there were no educational outreach's planned by the organization as part of their year to year activities. The location where the organization is located is not conducive for public display or viewing of items. All educational literature appears to be incidental to the selling of the items. Minimal educational material was available at the site

Section 1.513-1(d)(2) of the regulations provides that a trade or business is "substantially related" to purposes for which exemption is granted only if the production or distribution of the goods from which the gross income is derived "contributes importantly" to the accomplishment of those purposes.

The organization was granted exemption as an educational organization on the basis of its charitable and educational purposes in connection with fostering public knowledge and interest in various aspects of the artistic and cultural heritage of the United States and based on the above finding that the organizations activities are not defined as educational, accordingly, it is held that the sales activities will constitute unrelated trade or business under section 513 of the Code.

With respect to the examination of Form 990-T for Y the organization showed only the income from the organizations rental sale of its mailing lists.

### TAXPAYER POSITION

For the Y examination, A believes their activities are educational in nature in that with each item it sells, there is a pamphlet which describes the X. In addition the organization sponsored several books that were published as well assisted other exempt organizations in their fund raising efforts.

Note: A decided to agree to the proposed revocation and signed the Form 6018.

### CONCLUSION

The Internal Revenue Service intends to revoke its recognition of A as organization described in Internal Revenue Code section 501(c)(3) effective Date 1.



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY

Internal Revenue Service  
TE/GE:EO Examinations  
1100 Commerce Street  
Dallas, TX 75242

A = Organization/Address  
NUM = EIN  
Y = Tax Year Ended  
O = Officer  
TA = Taxpayer Advocate  
TAN = Taxpayer Advocate Number

A

Taxpayer Identification Number:

NUM

Form:

990/990T

Tax Year(s) Ended:

Y

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:

TA  
TAN

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

Enclosures:  
Form 6018  
Publication 3498  
Report of Examination