



DEPARTMENT OF THE TREASURY

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

**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

Number: **200752043**
Release Date: 12/28/2007

September 21, 2007

ORG

UIL: 501.03-01

CERTIFIED MAIL – RETURNED RECEIPTS

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 effective August 1, 19VV. You have agreed to this adverse determination, per signed Form 6018, on July 23, 20AA.

Our adverse determination was made for the following reasons:

1. The ORG is not operated for an exclusive exempt purpose, as is required by IRC section 501(c)(3) and Treas. Reg. section 1.501(c)(3)-1(d).
2. A substantial part of the activities of ORG furthers private interests (monies returned to trustee) rather than public interests, which is prohibited by Treas. Reg. section 1.501(c)(3)-1(d)(1)(ii). The foundation failed to make financial distributions or provide any activity as a supporting organization to a specified organization.
3. The organization did not operate exclusively for exempt purposes because it was organized and operated for the benefit of private interests, rather than public interests and its net earnings and assets inured to the benefit of its creators, trustees and directors., which is prohibited by IRC section 501(c)(3).

Please refer to the attached Form 886-A which sets forth the facts, law, and analysis upon which this final adverse determination is based.

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 the year ending July 31, 20XX, and for all years thereafter.

1100 Commerce Street Dallas, TX 75242

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 calling:

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

Attachment:
Form 886-A
Publication 892



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service
TE/GE EO Examinations

ORG

Taxpayer Identification Number:

Form:

990

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear :

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

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

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

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

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

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
Exempt Organizations 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 July 31, 20XX XX & July 31, 20YY YY

LEGEND:

Org = Organization	Founder1 – Founder/Officer1	Founder2 – Founder/Officer2
Founder Partnership	Member1 – Board Member 1	Member2 – Board Member 2
ABC – Related Company	DEF – Other Related Company	GHI – Related Company 3
A – Member GHI	B – Member GHI	C – Member GHI
D – Member DEF		

PRIMARY ISSUE: Should the IRC § 501(c)(3) tax exempt status of The ORG be revoked because it is not operated exclusively for tax exempt purposes?.

FACTS:

The ORG (the "Organization") was created with a Declaration of Trust (Declaration) on August 25, 19AA, by Founder1 and Founder2 (each being a "Founder"). Founder1 is also listed as the Trustee in the Declaration. Pursuant to the Declaration, the Organization was created for the purpose of establishing an organization which is described in IRC § 501(c)(3) and IRC § 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 that the Founder renounces any interest, either vested or contingent, including any reversionary interest or possibility of reverter, in the income or principal of the Trust estate.

By letter dated July 15, 19BB, the ORG received notification that it was recognized as tax exempt under section 501(a) as an organization described in section 501(c)(3) of the Internal Revenue Code and that it was not classified as a private foundation because it met the requirements of § 509(a)(3).

The Declaration requires that each year the Trustee shall distribute 30% of the adjusted net income to the ABC, the named Primary Charity. In addition to this distribution, each year the Trustee shall distribute a total of 55% of the adjusted net income to one or more identified charitable organizations or to the Primary Charity as directed by the majority of the Board of Directors (the "Board"). Schedule A of the Declaration identifies the supported charities. Schedule A has one hundred and seven charities listed.

Article 2.4 of the Declaration says that in the event the Trustee determines, in the Trustee's sole and complete discretion that the Trust Fund is too small to economically administer, then in such event the trustee shall distribute the trust fund in its entirety outright and free of trust to such organization or organizations as described in section 170(c)(2) of the Code as the Trustee, in Trustee's total and complete discretion, shall determine.

The Declaration provides that the Board shall be the governing body of the Organization and that the members of the Board shall be determined as follows:

- One Board member shall be appointed by the Primary Charity
- Two Board members shall be from the class consisting of Founder1 and Founder2 and each of their descendants (the Family).
- The other members of the Board shall be Member1 and Member2 .

While on paper, the Organization has one member of the board that is appointed by the Primary Charity, there are no records of board meetings to show that the board governed the Organization.

By August 1, 19CC, the Organization lent \$ to the Trustee and \$ to the Trustee's company, ABC . There were no loan documents. The balance sheets on the Forms CC0 listed notes receivables from trustees as an asset.

The following charts show the loans to each borrower from 19CC through April 7, 20ZZ. The information included in the charts is from lists of loans and payments prepared by the Organization's power of attorney (POA). The amounts in parenthesis are the payments on the principal. The interest paid on the notes is shown in the third column.

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According to information provided by the POA all of the loans were to the Trustee, the Trustee's businesses or the Trustee's family members.

	date	amount	balance	interest paid
Founder1				
borrowed prior to Aug 1,				
19CC				
	10/5/19CC			
	11/3/19CC			
	12/9/19CC			
	12/28/19CC			
	12/31/19CC			
	1/7/20DD			
	2/15/20DD			
	11/1/20DD			
	1/19/20EE			
	3/27/20EE			
	7/2/20EE			
	7/26/20EE			
	8/4/20EE			
	8/7/20EE			
	8/19/20EE			
	4/16/20GG			
	3/11/20YY			
	7/8/20YY			
	3/15/20YY			
	8/12/20YY			
	7/29/20VV			
	7/29/20VV			
	7/29/20VV			
	8/1/20VV			
	3/24/20WW			
	3/24/20WW			
	3/24/20WW			
	3/24/20WW			
	4/7/20WW			
	6/1/20ZZ			

	date	amount	balance	interest paid
ABC s				
Owed prior to 8/1/19CC				
	20DD			
	5/3/20EE			
	9/7/20EE			
	3/28/20GG			
	4/1/20GG			
	4/16/20GG			

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ABC s was owned by the Trustee, Founder1 . The company went bankrupt and the Trustee agreed to take over the debt. The \$ shown in the loan column was the interest due on the \$ for the year 20DD .

	date	amount	balance	interest paid
Founder's Partnership	3/6/20DD			
	3/10/20DD			
	4/16/20GG			

	date	amount	balance	interest paid
DEF	9/5/20DD			
	4/16/20GG			

	date	amount	balance	interest paid
GHI	11/21/20DD			
	11/28/20DD			
	12/8/20DD			
	12/8/20DD			
	12/16/20DD			
	1/18/20GG			
	3/22/20GG			
	4/16/20GG			
	6/7/20GG			
	7/11/20GG			
	7/26/20GG			
	8/21/20GG			
	8/22/20GG			
	8/30/20GG			
	10/15/20GG			
	1/11/20XX			
	3/14/20XX			
	5/23/20XX			
	6/3/20XX			
	6/5/20XX			
	7/10/20XX			
	10/7/20XX			
	12/5/20XX			
	12/12/20XX			
	12/17/20XX			
	3/15/20YY			
	4/7/20WW			
	6/1/20ZZ			

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Information from Choicepoint lists A, Founder1 , B, and C as members of the board of GHI LLC. Founder1 owns 24.47% of GHI. B owns 16.87% and A owns 16.87%. B and A are Founder1 's children.

	date	amount	balance	interest paid
C Investments	1/12/20EE			
	4/16/20GG			

	date	amount	balance	interest paid
D	11/5/20EE			
	1/31/20GG			

Founder1 has said that there is no family relationship between her and the Cs.

	date	amount	balance	interest paid
B	5/1/20GG			
	4/16/20GG			
	7/26/20GG			
	7/9/20XX			
	3/15/20YY			
	7/29/20VV			
	7/31/20VV			
	8/8/20VV			
	3/24/20WW			
	3/24/20WW			

B is Founder1 's son.

	date	amount	balance	interest paid
A	11/11/20GG			
	8/15/20XX			
	3/15/20YY			
	7/29/20VV			
	7/29/20VV			
	2/6/20WW			
	2/6/20WW			
	3/24/20WW			

A is Founder1 's daughter.

	date	amount	balance	interest paid
	12/22/20XX			
	3/15/20YY			
	7/29/20VV			

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3/24/20WW
is the Founder's Partnership.

date	amount	balance	interest paid
9/13/20VV			
3/24/20WW			

The charts show that there were no set repayment schedules for any of the notes. There were no documents provided on any of the notes. On December 5, 20XX, GHI paid \$ on its note and another payment of \$ was made on December 12, 20XX. Then on December 17, 20XX, it borrowed the \$ again.

The following chart is a list of the loans taken out by date and the balance owed to the Organization. The amount paid on the notes is in parenthesis.

date	amount borrowed/paid	amount borrowed amount paid	balance	interest paid
	Jul-CC			
	Jul-CC			
	31-Dec-CC			
	10/5/19CC			
	11/3/19CC			
	12/9/19CC			
	12/28/19CC			
	1/7/20DD			
	2/15/20DD			
	3/6/20DD			
	3/10/20DD			
	9/5/20DD			
	11/21/20DD			
	11/28/20DD			
	11/30/20DD			
	12/8/20DD			
	12/8/20DD			
	12/16/20DD			
	1/19/20EE			
	1/21/20EE			
	5/3/20EE			
	3/27/20EE			
	7/2/20EE			
	7/26/20EE			
	8/4/20EE			
	8/7/20EE			

Explanation of Items

Name of Taxpayer
ORGYear/Period Ended
July 31, 20XX
XX & July 31,
20YY YY

8/7/20EE
 8/19/20EE
 11/5/20EE
 1/18/20GG
 1/31/20GG
 3/22/20GG
 3/28/20GG
 4/1/20GG
 4/16/20GG
 5/1/20GG
 6/7/20GG
 7/11/20GG
 7/26/20GG
 7/26/20GG
 8/21/20GG
 8/22/20GG
 8/30/20GG
 10/15/20GG
 11/11/20GG
 1/11/20XX
 3/14/20XX
 5/23/20XX
 6/3/20XX
 6/5/20XX
 7/10/20XX
 7/9/20XX
 8/15/20XX
 10/7/20XX
 12/5/20XX
 12/12/20XX
 12/17/20XX
 12/22/20XX
 3/11/20YY
 3/15/20YY
 3/15/20YY
 7/8/20YY
 7/31/20YY
 8/12/20YY
 8/29/20YY
 8/1/20VV
 8/8/20VV
 9/13/20VV
 2/6/20WW
 3/24/20WW
 4/7/20WW

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4/7/20WW
5/31/20ZZ

The information on the payment of the notes shows that interest was paid. The interest rates ranged from 3% to 6%. These rates were equal to the prime interest rate charged for the periods the loans were taken out. The prime rate was taken from the Federal Reserve Board's web site on historical rates of interest. There is no evidence that a bank or other third party lender would have charged only the prime rate for unsecured, undocumented loans payable at will. According to the information provided by the Organization, the two notes written on April 7, 20WW , have an interest rate of 7%. The loan for \$ was to the Trustee and the one for \$ was to GHI LLC. On June 1, 20ZZ , the Trustee and GHI wrote checks to the Organization to pay off the notes.

From its inception through June 20ZZ , the Organization wrote fourteen checks for loans, five checks to the ABC, one check for tuition and one check to the Internal Revenue Service.

The chart below shows the amounts of grants paid out by the Organization, the portion of those grants that went to ABC and other charities. ABC used part of the grants it received to pay education expenses of the Trustee's children.

year end	Grants Paid	Amounts to ABC	other charities	education paid by ABC
July 31, 20EE				
July 31, 20GG				
July 31, 20XX				
July 31, 20YY				
July 31, 20VV				

The amounts for grants paid and the amounts paid to ABC are from the Forms 990 filed by the Organization.

According to information provided by the Trustee, when the Organization made a grant to ABC she could request a wish from it. In September 20VV , the Trustee sent a letter in regards to the Organization's association with ABC. In that letter she said, "Though my requests were honored (and as near as I can remember every time) – I understood completely, **ABC was under no obligation to grant my requests.** ORG wrote ABC a donation check. I then made the request to ."

The "wishes" made by the Trustee were for ABC to pay her family members' education expenses. The last column of the chart shown above is the amounts paid by ABC for the education expenses of the Trustee's family members. In January 20XX , a check for \$ was written from the Organization's account for the Trustee's children's education expenses.

LAW

IRC § 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

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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.

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

Regulation 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.

Regulation 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.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.509(a)-4(e)(1) of the regulations addresses permissible beneficiaries in that it specifies that a supporting organization will be regarded as "operated exclusively" to support one or more specified publicly supported organizations only if it engages solely in activities which support or benefit the specified publicly supported organizations. An organization will be regarded as "operated exclusively" to support or benefit one or more publicly supported organizations if it supports or benefits an organization, other than a private foundation, which is described in section 501(c)(3).

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).

In Founding Church of Scientology v. U.S., 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 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

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
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The IRC § 501(c)(3) exempt status of the ORG should be revoked because it is not operated exclusively for tax exempt purposes. The assets and the income of the Organization inured to the benefit of the founder/Trustee.

The Organization has directly and indirectly paid educational expenses for the Trustee's family. These payments are inurement. As set forth in Regulation section 1.501(c)(3)-1(c)(2) an organization is not operated exclusively for exempt purposes if any of the earnings inure to individuals that have a personal and private interest in the activities of the organization. Because there is inurement, the Organization is not operated exclusively for exempt purposes and should be revoked.

The Organization made loans to disqualified persons on terms that an independent lender would not have made. There are no set pay dates on the notes. There are no written documents or liens to give the Organization recourse to collect the debt. The interest rate is below what an independent lender would have charged for that type of loan (not secured, not documented). By not having set payment dates, the Organization does not know when it will have money to carry out its exempt purpose.

The fact that the loans were taken out shortly after the money was donated indicates the donors did not give up control of the money. The number of loans, timing of the loans and the amounts of the loans show that the Organization's bank account was used as a type of ready reserve account by the Trustee. When the Trustee needed some cash she took it out of the Organization's account.

In March 20GG , a large amount was paid back to the Organization, but in June 20GG that amount was taken out again. The same thing occurred in May 20XX ; a large payment was made on the notes and then loans were given in June 20XX . On March 24, 20WW , the loans were all paid off; two weeks later \$ was loaned out again to the Trustee and her Company.

The loans show that there was no requirement to even make annual payments of interest. The loans to Founder's Partnership, DEF , GHI, C Investments, and A were all over a year old before a payment was made on the note.

The checks were signed by the Trustee, Founder1 . There is no record of meetings to show that the board discussed if the loans were a good investment.

The primary activity of the Organization is loaning money to the Trustee, her family and her businesses. Even when there was a grant to the Primary Charity, the Trustee requested that the money be used for her "wish".

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 ensure that charitable assets are dedicated exclusively to 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. Treas. Reg. § 1.501(c)(3)-1(c)(1).

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. 20DD). The 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 returning assets to the Trustee, her business and her

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family members, the Organization breached the dedication requirement and its net earnings have inured to the benefit of 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 Organization's net earnings have inured to the benefit of insiders. Treas. Reg. § 1.501(a)-1(c); Ginsburg v. Commissioner, 46 T.C. 47 (1966). The very presence of a private source of loan credit may amount to inurement. Founding Church of Scientology v. United States, 412 F.2d 1197 (Ct. Cl. 1969); Church in Boston v. Commissioner, 71 T.C. 102 (1978). Loans to disqualified persons promote private rather than charitable purposes. Best Lock Corporation v. Commissioner, 31 T.C. 1217, 1235-37 (1959).

Accordingly, the Organization's status as an organization described under section 501(c)(3) should be revoked, effective August 25 CC because it did not operate exclusively for exempt purposes and its assets inured to, and it served the private interests of, its creators.

TAXPAYER'S POSITION

The taxpayer has indicated that it agrees to revocation by signing the Form 6018.

CONCLUSION

The Organization's exempt status should be revoked back to August 25, 19AA. Retroactive revocation is appropriate because the Organization did not state in its application that it would make loans on terms more favorable than an independent lender would make, that it would lend most of its assets to insiders, and that some of its grants would be used to pay education expenses for the Trustee's family members.