

the district court of the United States for the District of Columbia before the (ninety-first) 91st day after the date that this determination was mailed to you. Contact the clerk of the appropriate court for rules for initiating suits for declaratory judgment by referring to the enclosed Publication 892.

You may write to the United States Tax Court at the following address: United States Tax Court 400 Second Street, NW Washington, DC 20217

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 the Taxpayer Advocate assistance or you can contact the Advocate from the site where this issue was determined by writing to:

Taxpayer Advocate assistance cannot be used as substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determination, nor extend the time fixed by law that you have to file a petition in 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.

As a result of this revocation of tax-exempt status, your organization is required to file Form 1120 annually with the appropriate Campus identified in the instructions.

This letter is a final revocation letter and should be kept within your permanent records.

If you have any questions, please contact the person whose name and telephone number are shown above.

Sincerely,

Marsha Ramirez
Director, EO Examinations

Enclosures:
Publication 892



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service

April 21, 2006

ORG
Address

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 Ramirez
Director, EO Examination

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 December 31, 20XX

Legend

ORG = Organization Name Address = address XX = Date XYZ = State
City = city RA = Registered Agent Director = director motto = motto

Issue:

Should the exempt status of ORG under Section 501(a) of the Internal Revenue Code (IRC) as an organization described in IRC Section 501(c)(3) be revoked for all years beginning on January 1, 20XX, due to inurement, private benefit and violations of state and local law?

Facts:

A XYZ certificate of incorporation was issued to ORG on April 23, 19XX. According to XYZ Commonwealth records, the address of ORG is: Address City, XYZ.

These records indicated that the Registered Agent of ORG is RA; address is listed as: Address, City, XYZ.

In addition, these records list RA and Director as the sole Directors of ORG. The Commonwealth of XYZ terminated the certificate of incorporation on August 31, 20XX due to the non-payment of the annual fee of \$.

Based on records from the Internal Revenue Service, ORG, received its non-profit determination letter (Internal Revenue Code Section 501(c)(3) ruling) in April, 19XX.

(The following information was extracted from court documents submitted to the Examination Division of the Exempt Organization Division of the Internal Revenue Service from the Criminal Investigation Division of the Internal Revenue Service):

RA and Director (the defendants) were employed as Specialists with the . These two individuals were also simultaneously operating the non-profit organization, ORG. The non-profit purpose of this organization was to raise money to purchase computers for children and schools in need. Based on its status as a non-profit organization, ORG was able to acquire a license from the XYZ Department of Charitable Gaming to conduct weekly motto for the purpose of raising money for its charitable purpose.

From January, 19XX to January, 20XX, the defendants and others operated the motto under the guise that all proceeds, excluding purchases of supplies and payment for an on-site security officer, would be applied for the charitable purpose for which the organization was formed. Officers and any other persons affiliated with ORG were prohibited from receiving any compensation from the motto proceeds.

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The defendants, during this period, diverted the proceeds from the weekly motto for their own personal use in violation of the laws of the United States. The defendants conspired to achieve this malfeasance by misappropriating funds from the ORG bank account and using this money to repay personal loans. Payments were also made to individuals who were working at the motto who should not have received any payment for their services, again in violation of the law.

RA and Director, the Officers of ORG, were deliberately maintaining a double set of books throughout years the motto were in operation. One set of records listed the actual receipts of the motto; the second set of receipts reduced the figures. The reduced figures were the ones in which the defendants reported to the XYZ Department of Charitable Gaming.

In April, 20XX, the XYZ Department of Charitable Gaming began an audit of the records of ORG to conceal payments made to themselves and others from the examining officials, the defendants altered ORG bank statements and checks and submitted these altered and forged bank statements to the XYZ Department of Charitable Gaming.

RA and Director, the Officers of ORG, failed to file Internal Revenue Service Form 990 after receiving notice from both the Internal Revenue Service and the XYZ Department of Charitable Gaming that the filing of this form was required. The defendants submitted a fictitious Internal Revenue Service Form 990 for the year 20XX to the XYZ Department of Charitable Gaming. This form, nor any other required IRS Form 990, was ever filed with the Internal Revenue Service. The defendants also submitted fictitious individual IRS Forms 1040 to the Internal Revenue Service.

RA and Director, the Officers of ORG, were eventually charged with various crimes against the United States by the United States Attorney, in the United States District Court for the District of XYZ. These charges all relate to the above stated facts, in addition to the misappropriation of the motto game proceeds which were held under the auspices of ORG

In February, 20XX, the defendants agreed to and signed a plea agreement with the United States Attorney in the United States District Court for the District of XYZ. The defendants plead guilty to all the above cited facts. The defendants were sentenced to serve six months each in the City, XYZ. Their expected release dates are February 23, 20XX.

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Law:

All organizations seeking exemption under **Internal Revenue Code Section 501(c)(3)** must conform to certain fundamental legal principles applicable to all charitable organizations. One of these basic charitable principles is that charitable organizations may not engage in behavior that is illegal or violates public policy.

The illegality doctrine derives from English charitable trust law, the legal foundation on which **Internal Revenue Code Section 501(c)(3)** was established. Under charitable trust law, trusts violating law or public policy cannot qualify for charitable status. The law of charity provides no basis for weighing or evaluating the objective merits of specific activities carried on in furtherance of a charitable purpose, if those activities are reasonably related to the accomplishment of the charitable purpose, and are not illegal or contrary to public policy. See Restatement (Second) of Trusts, section 374, comment 1 (1959).

Internal Revenue Code Section 501(a) allows organizations described in subsection 501(c) to be exempt from taxation.

Internal Revenue Code 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 to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), 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 (except as otherwise provided in subsection (i)), 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.”

Internal Revenue Code Section 6033(a)(1) requires that, except as provided in section 6033(a)(2), every organization exempt from tax under section 501(a) shall file an annual return, stating specifically the items of gross income, receipts and disbursements, and such other information for the purposes of carrying out the internal revenue laws as the Secretary may by forms or regulations prescribe, and keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Secretary may from time to time prescribe.

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Section 1.501(c)(3)-1(a) of the **Income Tax Regulations** provides that an organization cannot be exempt under section 501(c)(3) of the Code unless it meets both an organizational and operational test. That is, the organization must be both organized and operated exclusively for charitable purposes.

In determining whether an organization meets the operational test, the issue is whether the particular activity undertaken by the organization is appropriately in furtherance of the organization's exempt purpose, not whether that particular activity in and of itself would be considered charitable. Moreover, the fact that the activity reflects a particular viewpoint or opinion on a controversial issue does not preclude the organization from qualifying for exemption under section 501(c)(3) of the Code. See section 1.501(c)(3)- 1(d)(2) of the regulations.

Treas. Reg. § 1.501(c)(3)-1(a)(1) requires 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.”

Treas. Reg. § 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in IRC § 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Treas. Reg. § 1.501(c)(3)-1(c)(2) states 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.”

Treas. Reg. § 1.501(a)-1(c) defines private shareholder or individual as “persons having a personal and private interest in the activities of the organization.”

Treas. Reg. § 1.501(c)(3)-1(c)(2) provides that the operational test is not satisfied where any part of the organization's earnings inure to the benefit of private shareholders or individuals, and where the organization serves a private rather than a public interest.

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Treas. Reg. § 1.501(c)(3)-1(d)(1)(i) provides that an organization may be exempt as an organization described in section 501(c)(3) if it is organized and operated exclusively for one or more of the following purposes:

- (a) Religious,
- (b) Charitable
- (c) Scientific,
- (d) Testing for public safety,
- (e) Literary
- (f) Educational, or
- (g) Prevention of cruelty to children or animals.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for one or more of the purposes specified in IRC 501(c)(3) unless it services a public rather than a private interest.

Treas. Reg. § 1.501(c)(3)-1(d)(2) includes in the definition of “charitable” or “charity”, the following:

- (a) Relief of the poor and distressed or of the underprivileged,
- (b) Advancement of religion,
- (c) Advancement of education or science,
- (d) Erection or maintenance of public buildings, monuments, or works,
- (e) Lessening of the burdens of Government, and
- (f) Promotion of social welfare by organization designed to accomplish any of the above purposes, or
 - (i) To lessen neighborhood tensions,
 - (ii) To eliminate prejudice and discrimination,
 - (iii) To defend human and civil rights secured by law, or
 - (iv) To combat community deterioration and juvenile delinquency.

Treas. Reg. § 1.501(c)(3)-1(d)(3) provides that “educational”, as defined in section 501(c)(3) of the Code, includes the instruction or training of individuals for the purpose of improving or developing their capabilities, or the instruction of the public on subjects useful to the individual and beneficial to the community.

Therefore, in making the determination of whether an organization's activities are consistent with exemption under section 501(c)(3) of the Code, the Service will rely on a three-part test, as stated in **Revenue Ruling 80-278 (1980-42 I.R.B. 8)**.

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Accordingly, the organization's activities will be considered permissible under section 501(c)(3) if:

- (1) The purpose of the organization is charitable;
- (2) **the activities are not illegal, contrary to a clearly defined and established public policy, or in conflict with express statutory restrictions;** and
- (3) the activities are in furtherance of the organization's exempt purpose and are reasonably related to the accomplishment of that purpose.

Revenue Ruling 71-447, (1971-2 C.B. 230), in interpreting section 501(c)(3) of the Code, concluded that an organization is not operated exclusively for charitable purposes if its activities are carried on in a manner that can be reasonably classified as contrary to well-established Federal public policy.

Revenue Ruling 59-95, (1959-1 C.B. 627), concerns an exempt organization that was requested to produce a financial statement and a statement of its operations for a certain year. However, its records were so incomplete that the organization was unable to furnish such statements. The Service held that the failure or inability to file the required information return or otherwise to comply with the provisions of section 6033 of the Code and the regulations which implement it, may result in the termination of the exempt status of an organization previously held exempt, on the grounds that the organization has not established that it is observing the conditions required for the continuation of exempt status

In addition to the above stated Federal laws and regulations, the **Commonwealth of XYZ**, as stated in the **XYZ Administrative Code** (), has these regulations that must be adhered to by motto and other charitable gaming operators:

Section of the XYZ Charitable Gaming Statute states that (1) No part of the gross receipts derived by a qualified organization may be used for any purpose other than (i) reasonable and proper gaming expenses, (ii) reasonable and proper business expenses, (iii) those lawful religious, charitable, community or educational purposes for which the organization is specifically chartered or organized, and (iv) expenses relating to the acquisition, construction, maintenance, or repair of any interest in the real property involved in the operation of the organization and used for lawful religious, charitable, community or educational purposes...

(2) Except as provided in § , no qualified organization shall enter into a contract with or otherwise employ for compensation any person for the purpose of organizing, managing, or conducting any charitable games. Thus, employees are prohibited..

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In **Arlie Foundation, Inc. V. United States of America, D.D.C., 826 F. Supp.537**, the District Court upheld the revocation of Arlie Foundation's tax-exempt status. The District court upheld the revocation because Arlie Foundation operated for non-exempt purposes and for private inurement. In 1979, Dr. Murdock Head, the founder and executive director of AFI, was convicted in the Eastern District of XYZ of conspiracy to commit tax fraud and to bribe public officials. The Fourth Circuit reversed the conviction based on an improper jury instruction. *United States v. Head*, 641 F.2d 174 (4th Cir.1981). Dr. Head was retried and again convicted in 1981. The conviction was affirmed in *United States v. Head*, 697 F.2d 1200 (4th Cir.1982), *cert. denied*, *539 462 U.S. 1132, 103 S.Ct. 3113, 77 L.Ed.2d 1367 (1983). Following the criminal case, the Internal Revenue Service initiated an investigation of Arlie Foundation's tax-exempt status for the years 1976 through 1980. At the conclusion of the investigation, the Internal Revenue Service determined that the Arlie Foundation did not operate exclusively for exempt purposes because it operated for the private benefit of Dr. Head. In 1988, the Internal Revenue Service issued a notice of determination which revoked, effective January 1, 1976, Arlie Foundation's tax-exempt status as a section 501(c)(3) organization.

In **Freedom Church of Revelation v. United States of America. 588 F.Supp. 693**, the court had to determine if the exempt organization (1) "operated exclusively" for tax-exempt purposes, in accordance to IRC section 501(c)(3);; (2) that no part of its net earnings inured to the benefit of any private individual., and (3) and if the revocation should be imposed retroactively?

With regard to the first requirement of section 501(c)(3), *i.e.*, that an organization must be operated exclusively for an exempt purpose, the applicable regulations state as follows:
(c) *Operational test* --(1) *Primary activities*. 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.*

Based on similar court cases, the Court wrote that if the nonexempt activities of the plaintiff are more than incidental or insubstantial, it is not entitled to continuing qualification as an exempt organization. The presence of a single noneducational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes. If there is present in [an organization's] operations a single noncharitable purpose substantial in nature, though it may have other truly and important charitable purposes, it is not entitled to be exempt.

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The Court examined the documents presented by Freedom Church, and determined that the plaintiff did not operate exclusively for religious, charitable or educational purposes. Plaintiff has failed to provide any financial records to buttress its claims that it is organized primarily for exempt purposes under section 501(c)(3). Moreover, the United States has presented evidence, which has not been refuted, that a substantial activity engaged in by plaintiff was the promotion of tax-avoidance schemes.

Section 501(c)(3) clearly states that an organization must be operating *exclusively* for religious, charitable, educational or other exempt purposes. Tax avoidance schemes do not qualify as "other exempt purposes." Because more than an insubstantial part of its activities is not in furtherance of an exempt purpose, plaintiff has not met the "operational test". Therefore, the Court finds that plaintiff has failed to meet the first requirement of section 501(c)(3) that it be "operated exclusively" for one or more exempt purposes.

The Court also concluded that even if the plaintiff did meet its burden of proving that it is "operated exclusively" for an exempt purpose, plaintiff fails to meet the second requirement of section 501(c)(3), *i.e.*, that its assets do not inure to the private benefit of private shareholders or individuals. A "private shareholder or individual" refer [s] to persons having a personal and private interest in the activities of the organization," and includes the creator of the organization and his family. The requirement that there be no private inurement overlaps the requirement that an organization must operate exclusively for exempt purposes. Clearly, if part of an organization's earnings inure to the benefit of private individuals, the organization cannot be operating exclusively for exempt purposes.

The Court was shown documents which substantiated that a total of \$335,592.23 was disbursed by check from two Freedom Church accounts to various debtors, all personal in nature. In the absence of any evidence submitted by plaintiff to explain how the funds in these church accounts were used for legitimate church purposes, the Court must conclude that the funds in these accounts inured to the founder's personal benefit. Under any standard of proof, plaintiff has not established that its earnings did not inure to private individuals as required under section 501(c)(3) of the Code. Because plaintiff has failed to meet the requirements of section 501(c)(3), the Court finds that it is not entitled to continuing qualification as an exempt organization.

Finally, the Court had to determine whether the revocation should be imposed retroactively. Title 26, Code of Federal Regulations, section 601.201(1)(5), provides in pertinent part: Except in rare or unusual circumstances, the revocation or modification of a ruling will not be applied retroactively with respect to the taxpayer to whom the ruling was originally issued or to a taxpayer whose tax liability was directly involved in such ruling if (i) there has been no

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misstatement or omission of material facts, (ii) the facts subsequently developed are not materially different from the facts on which the ruling was based, (iii) there has been no change in the applicable law, (iv) the ruling was originally issued with respect to a prospective or proposed transaction, *and* (v) the taxpayer directly involved in the ruling acted in good faith in reliance upon the ruling and the retroactive revocation would be to his detriment.

The Court determined that the plaintiff does not meet all of the requirements set forth in this regulation, thus, it cannot avoid retroactive application of this revocation. The facts upon which the revocation is based are materially different from the representations made in plaintiff's original application for exemption upon which an exemption was granted in 1979. It was only after the IRS granted a tax exemption to plaintiff pursuant to section 501(c)(3) that the IRS found out that Freedom Church was actively promoting tax-avoidance methods and that its earnings were inuring to private individuals, including its leaders. Clearly, these facts as subsequently developed differ materially from the facts on which the original ruling was based.. Accordingly, the Court sustained the retroactive application of the revocation of plaintiff's tax-exempt status.

Government's Position

The officers of ORG had properly incorporated the organization in accordance to Commonwealth of XYZ regulations. However, from January, 19XX to January, 20XX, RA and Director had willfully and specifically violated **Internal Revenue Code Section 501(c)(3)** by diverting the proceeds from the weekly motto for their own personal use. The defendants have admitted to using part of the proceeds to repay personal loans. These willful acts of diversion are clearly inurement which benefited the officers. Since the officers of ORG intentionally and willfully perpetuated actions which are in violation of **Internal Revenue Code Section 501(c)(3)**, the Internal Revenue Service is proposing that the exempt status of the organization be revoked.

Since the officers of ORG knowingly and willingly carried out activities in a manner that are contrary to State and Federal public policy, the Internal Revenue Service is proposing that the exempt status of the organization be revoked. The officers have admitted their participation in the following acts:

- RA and Director have admitted to having made payments to individuals who were working at the motto and who should have not received any payments for their services. Officers and any other persons affiliated with ORG were prohibited from receiving any compensation from the motto proceeds in accordance to Commonwealth of XYZ laws.

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- The Officers of ORG, were deliberately maintaining a double set of books throughout the years the motto were in operation. One set of records listed the actual receipts of the motto; the second set of receipts reduced the figures. The reduced figures were the ones in which the officers reported to the XYZ Department of Charitable Gaming. This reporting of fictitious records to a government body is clearly contrary to public policy.
- In April, 20XX, the XYZ Department of Charitable Gaming began an audit of the records of ORG to conceal payments made to themselves and others from the examining officials, the defendants altered ORG bank statements and checks and submitted these altered and forged bank statements to the XYZ Department of Charitable Gaming. Again, this reporting of fictitious records to a government body is clearly contrary to public policy.
- RA and Director failed to file Internal Revenue Service Form 990 after receiving notice from both the Internal Revenue Service and the XYZ Department of Charitable Gaming that the filing of this form was required. The defendants submitted a fictitious Internal Revenue Service Form 990 for the year 20XX to the XYZ Department of Charitable Gaming. This form, nor any other required IRS Form 990, was ever filed with the Internal Revenue Service. The defendants also submitted fictitious individual IRS Forms 1040 to the Internal Revenue Service. These willful and deliberate acts, perpetuated by the officers of the organization, have been interpreted as being in contrary to well-established Federal public policy, and thus, in violation of **Internal Revenue Code Section 501(c)(3)**, and cited as such in **Revenue Ruling 71-447, (1971-2 C.B. 230)**.

In consideration of all the previously reported illegalities which occurred during the operation of ORG, from January, 19XX to January, 20XX, and which were willfully and purposely incurred by the officers of the organization, the Internal Revenue Service has determined that the organization does not meet the “three-part activities test” as referenced in **Revenue Ruling 80-278 (1980-42 I.R.B. 8)**, and thus ineligible to be tax exempt under **Internal Revenue Code Section 501(c)(3)**.

Taxpayer’s Position:

Taxpayer has not responded to Service’s letters.

Conclusion:

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Due to the determination that ORG has conducted activities that are in violation of **Internal Revenue Code Section 501(c)(3)**, the Internal Revenue Service is proposing that the tax exempt status of this organization be revoked for all years beginning on January 1, 20XX.