

200810025

Internal Revenue Service
SE:T:EO:MA:7928
5990 West Creek Road
Independence, OH 44131-2190

Department of the Treasury

Employer Identification No.:

Release Date: 3/7/08
Date: November 13, 20XX

Person to Contact:
Employee ID Number

Tel:

Fax:

Form Required to be Filed:
1041

Tax Years:

December 31, 20XX and subsequent
years

Last Day to File a Petition with the
United States Tax Court:

February 11, 20XX

ORG
Address

UIL: 501.03-01

Certified Mail

ORG:

This is a final adverse determination as to your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC). It is determined that you are no longer recognized as exempt from Federal income tax under IRC section 501(c)(3), effective December 28, 20XX, for the following reason(s):

You are not organized and operated exclusively for exempt purposes specified under IRC section 501(c)(3). More than an insubstantial part of your activities are in furtherance of non-exempt purposes and benefit private interests.

Contributions to your organization are not deductible under IRC section 170.

You are required to file Federal income tax returns on the form indicated above. You should file these returns within 30 days from the date of this letter, unless a request for an extension of time is granted. File the returns in accordance with their instructions, and do not send them to this office. Processing of income tax returns and assessment of any taxes due will not be delayed because you have filed a petition for declaratory judgment under IRC section 7428.

If you decide to contest this determination under the declaratory judgment provisions of IRC section 7428, a petition to the United States Tax Court, the United States Court of Claims, or the district court of the United States for the District of Columbia must be filed within 90 days from the date this determination letter was mailed to you. Contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 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 Taxpayer Advocate assistance or you can contact your nearest Advocate's office, in this case by calling _____ or writing to:

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 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 section 6104(c). You should contact your state officials if you have any questions about how this determination may affect your state responsibilities and requirements.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer ORG		Year/Period Ended 12/31/20XX

Legend

ORG = Organization name XX = Date Founders = founders CPA = CPA
 BM1 = 1st Board Member BM2 = 2nd Board member Primary Charity = Charity
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 CO-3 = 3rd company CO-4 = 4th company Attorney = attorney

PRIMARY ISSUE:

Whether the IRC § 501(c)(3) tax exempt status of The ORG should be revoked because it is not organized and operated exclusively for tax exempt purposes.

FACTS:

A Declaration of ORG was entered into on December 28, 20XX, by Founders (the "Founders" or, each individually, a "Founder"), and Founders (the "Trustee"). The name of the trust is the ORG (hereinafter, referred to as either the "ORG" or the "Organization").

The Declaration of ORG provides, in relevant part, as follows:

- The ORG is established for the purpose of establishing an organization which is described in IRC § 501(c)(3) and IRC § 509(a)(3), and which is tax exempt under IRC § 501(a). The ORG is organized, and at all times thereafter will be operated, exclusively to support or benefit, as defined by Treasury Regulation §1.509(a)-4(b)(1), one or more publicly supported organizations and shall comply with all other requirements of section 509(a)(3).
- The ORG shall be irrevocable and the Founders expressly waive the right and the power to alter, amend, revoke or terminate the ORG or any of the terms of the Declaration of ORG. The Founders also renounce any power to determine or control, by alteration, amendment, revocation, termination, or otherwise, the income or principal of the ORG estate. In addition, the Founders renounce any interest, either vested or contingent, including any reversionary interest or possibility of reverter, in the income or principal of the ORG estate.
- Each year the Trustee shall distribute % of the net income of the ORG to the Primary Charity (hereinafter, referred to as the "Primary Charity"), a charitable organization qualified under section 501(c)(3). In addition, each year the Trustee shall distribute a minimum of 50% of the net income of the ORG to one or more of the organizations listed on a Schedule A, that is supposed to be attached to the Declaration of ORG, or to the Primary Charity as directed by a majority of the Organization's Board of Directors (the "Board") in writing, provided that each such distribution shall be a distribution which can be made by an organization described in section 509(a)(3).
- Upon winding up and dissolution of the ORG, after paying or adequately providing for the debts and obligations of the ORG, the remaining assets shall be distributed to a non-

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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 Trustee shall render at least annually an account of income and principal, including a statement of all receipts, disbursements and capital changes, to the Board and to the Primary Charity.

The Declaration of ORG further provides that the Board must have at least three (3) members, but no more than five (5) members, and that the members of the Board are determined as follows:

- **Charity Member of the Board:** One Board member shall be appointed by the Primary Charity or its designated agent.
- **Family Members of the Board:** Two Board members shall be from the class consisting of Founders, their children and their descendants (the "Founders' Family"), provided that there are then at least two members of the Founders' Family who are willing and able to so act.
- **Other Members of the Board:** The other Members of the Board shall be BM1 and BM2.
- **Control, Actions and Rules:** The membership of the Board shall at all times be such that the original Founders or other disqualified persons, as defined in IRC § 4946, do not control the Board.

No Schedule A is attached to the Declaration of ORG.

On March 8, 20XX, the Organization filed Form 1023, an Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code. The Form 1023 states that the purpose of the Organization is to distribute substantially all of its income to and for the use of various public charities and to help Primary Charity carry out its purposes and perform its functions. In order to do so, the Form 1023 states that the Organization's Board will donate sufficient funds to support activities promoting Primary Charity's mission: i.e.; to fulfill a heartfelt wish for a child between the ages of and who has a life-threatening illness and to offer comfort and joy to the child and the entire family during an otherwise frightening period of their lives. In addition, the Form 1023 makes the following representations: Each year, at least % of the net income of the Organization will be distributed to the Primary Charity. The

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Organization's Board, which includes a member appointed by the Primary Charity, will work with the governing board of the Primary Charity to establish the use of these distributions. It is intended that the distributions will be used each year to carry out or fund a substantial and important program or function of the Primary Charity. In addition, each year at least % of the net income of the Organization will be distributed among designated public charities listed on Schedule A of the Organization's indenture, as determined by the Organization's Board.

The Form 1023 lists the following officers, directors, or trustees:

- Founders, Trustee and Board Member
- Founders, Board Member
- BM1, Board Member
- BM2, Board Member
- Charity Board Member – no name given

The Form 1023 includes the question "Are any members of the organization's governing body 'disqualified persons' with respect to the organization (other than by reason of being a member of the governing body) or do any of the members have either a business or family relationship with 'disqualified persons'?" The response given to this question is "Founders and Founders may be disqualified because they are substantial contributors to the organization".

The Form 1023 further includes the statement that the Organization has a special relationship with the Primary Charity since one of its board members is appointed by the Primary Charity, which will have substantial and significant input over the Organization. Moreover, the Form 1023 indicates that the Organization is required to give periodic accounting (at least annually) to the Primary Charity.

The Form 1023 also includes a financial statement for the period ending 12/31/20XX and proposed budgets for 20XX, 20XX and 20XX, reflecting the following:

	TY 20XX	TY 20XX	TY 20XX	TY 20XX
Contributions	\$	\$	\$	\$
Investment Income	\$	\$	\$	\$
Total	\$	\$	\$	\$
Contributions	\$	\$	\$	\$
Compensation of officers	\$	\$	\$	\$

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Total	\$	\$	\$	\$
Excess	\$	\$	\$	\$

Schedule D of the Organization's Form 1023 provides that the Primary Charity appoints one of the five Board members of the Organization. The Board controls the investment policy, the making of grants and all other activities of the Organization. In addition, the Primary Charity is entitled to periodic accounting.

In response to the request for the total annual income of the supported organization, the Form 1023 states that the Organization is waiting for the Primary Charity to obtain the information. The Schedule D also states that the Organization's governing instrument provides that its Board, in concert with the governing board of the Primary Charity or its representatives, put in place a plan by which distributions from the Organization to the Primary Charity will be used to fund a substantial and important program or function that would not be otherwise done by the Primary Charity. Further, the Schedule D indicates that the Organization is not controlled, directly or indirectly, by one or more "disqualified persons" (other than one who is a disqualified person solely because he or she is a manager) or by an organization that is not described in section 509(a)(1) or (2).

By letter dated April 23, 20XX, the Organization was recognized as exempt from federal income tax as an organization described in section 501(c)(3). It was further determined that the Organization was not a private foundation because it was described in section 509(a)(3).

In a letter dated May 24, 20XX, Founders provided the following information: BM1 (listed as BM1 on the Form 1023) and BM2 are sisters of Founders, his wife; they are consulted during the Christmas season, when the Board members discuss the Primary Charity in general and if anyone has suggestions for a distribution for the year; and Founders appoint the Trustee and Board members.

Founders has stated that he had contacted Primary Charity to request that it appoint a Board member and the Primary Charity refused.

The following information has also been submitted:

- The Organization does not have formal meetings.
- The Organization does not distribute publications.

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- The Organization has no contracts, leases, mortgages, or promissory notes.
- The Organization does not have books of account.
- There were no transactions with foreign charities/entities.
- There are no CPA reports.
- There were no financial reports given to any organizations.
- There were no monies returned or loaned to the Founders in 20XX. In 20XX, a check in the amount of \$ was issued to Founders.

The Forms 990 for the years 20XX, 20XX, 20XX and 20XX reflect the following:

<u>Revenue:</u>	<u>TY 20XX</u>	<u>TY 20XX</u>	<u>TY 20XX</u>	<u>TY 20XX</u>
Contributions	\$	\$	\$	\$
Interest	\$	\$	\$	\$
Total	\$	\$	\$	\$
<u>Expenses:</u>				
Bank Charges	\$	\$	\$	\$
Grants	\$	\$	\$	\$
Legal Fees	\$	\$	\$	\$
Telephone	\$	\$	\$	\$
Postage	\$	\$	\$	\$
Printing/pub	\$	\$	\$	\$
Travel	\$	\$	\$	\$
Office Expense	\$	\$	\$	\$
State Registration Fees	\$	\$	\$	\$
Utilities	\$	\$	\$	\$
Total	\$	\$	\$	\$
Excess(Deficit)	\$	\$	\$	\$

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Assets:

Savings	\$	\$	\$	\$
Total	\$	\$	\$	\$
<u>Liabilities</u>	\$	\$	\$	\$

Based on the records reviewed, the following grants have been made by the organization:

<u>Grants:</u>	<u>TY 20XX</u>	<u>TY 20XX</u>	<u>TY 20XX</u>	<u>TY 20XX</u>
	\$	\$	\$	\$
	\$	\$	\$	\$
Total	\$	\$	\$	\$

In response to a request for additional information on the expenses for 20XX, the following information was provided:

Legal Fees Amount Per Return \$

Per the response, this should have been reported as accounting fees.

An undated statement from CPA was submitted showing that for the preparation of the Forms 990 for 12/31/20XX and 12/31/20XX and for conferences he was paid \$.

No checks were issued from the Organization's account to CPA.

Telephone Expense Amount Per Return \$

Founders estimated that % of his personal phone bill was used for the Organization's business. A bill dated 7/4/20XX was submitted showing charges for the month of \$. He used \$ a month X 24 months (20XX and 20XX) to come up with the \$. Previously, he had indicated that each year over the Christmas holidays his wife, his wife's two sisters and he would discuss the charitable distributions.

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Postage Amount Per Return \$

Per the response, this expense was to ship items between his two residences (XYZ and XYZ). One receipt was submitted for \$ dated 5/11/20XX. No other receipts are available.

Printing Amount Per Return \$

Per the response, this was for the purchase of a copier/printer/fax/scanner and supplies. A receipt from CO-1 in XYZ dated 10/29/XX was submitted for this item. The copier cost \$ with other items purchased for a total of \$. There was also a receipt from CO-2 (date is illegible) for various supply items totaling \$.

Travel Expenses Amount Per Return \$

Per the response, this represents reimbursements for a portion of travel costs between XYZ and XYZ. Also reimbursed were meals with trustees and board members. Invoices were submitted for hotels and restaurants. Receipts are dated in 20XX and 20XX. No evidence of any records being maintained detailing the business relationship of the meals, those who attended, etc. Receipts total \$.

Office Expense Amount Per Return \$

Per the response, this represents office expenses as well as an allocation of office furniture purchased for an office. Invoices for various office type items total \$. Invoices for \$ submitted for what appears to be home furnishings for which % has been allocated to the Organization.

Utilities Amount Per Return \$

Per the response, this represents estimates for 20XX and 20XX. An expense of \$ per month was reimbursed. This was based on \$ for XYZ utilities for six months and \$ for six months of utilities for XYZ for a total of \$ X 2years X % = \$.

The expenses above total \$. On December 26, 20XX, a check was written from the Organization's account to Founders in the amount of \$ as reimbursement for expenses.

Founders spend six months a year at their residence in XYZ and six months a year at their residence in XYZ. While in XYZ, Founders runs his XYZ business.

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On July 30, 20XX, a report was issued to Founders disallowing the \$ charitable contribution deduction on their 20XX Form 1040. This deduction represented the amount contributed to the Organization.

As a result of this adjustment, on November 4, 20XX, a Notice of Tax Due on Federal Tax Return was issued assessing \$ in additional tax and \$ in interest for a total assessment of \$. On November 6, 20XX, Founders issued a check to the United States Treasury in the amount of \$.

On February 7, 20XX, a check was drawn on the Organization's bank account payable to Founders in the amount of \$. This was the balance in the account on that date.

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 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.

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.

Regulation 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.

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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 § 501(c)(3) tax exempt status of the ORG (the "Organization") should be revoked because it is not organized and operated exclusively for tax exempt purposes.

The Facts show that the Organization is not operated exclusively for a tax exempt charitable purpose. Rather, Founders have operated the Organization for their own personal benefit. The Founders formed the Organization for tax avoidance purposes. The documentation reviewed demonstrates that the Founders established the Organization to obtain tax benefits in the form of claiming charitable contribution deductions under section 170, without relinquishing control of the assets that they claimed to have contributed to the Organization.

TAXPAYER'S POSITION:

In response to the initial determination of the Internal Revenue Service (the "Service"), dated September 1, 20XX, that the ORG (the "Organization") should be reclassified as a private foundation, the Founders contend that the Organization should be neither a supporting organization nor a private foundation since it qualifies as an "abusive trust" and "sham" under the doctrine of substance over form as articulated by the Service and the courts.

The supporting organization plan was tailored by a Managing Director of CO-3. The Founders relied on the knowledge of Managing Director, CO-3, Attorney, the attorney who drafted the trust documents for the Organization, and CO-4, a company affiliated with CO-3. According to the Service, these individuals and entities offered a tax evasion and tax avoidance plan that does not meet the technical and factual standards of a supporting organization. In 20XX, the Founder agreed with this conclusion by conceding the income tax deduction they claimed in 20XX for their contribution to the Organization, paying all income taxes relating to the deduction, including interest, and withdrawing all sums remaining in the Organization's bank account. Therefore, the Founder are in agreement with the Service that the Organization should be disregarded as a sham.

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However, the Founder also argue that the Service's initial position of reclassifying the Organization to a private foundation is not warranted. The Service had ample opportunity to evaluate all management procedures prior to issuing the determination letter stating that the Organization qualified as a supporting organization. It is inappropriate to now identify ministerial flaws that were apparent at the inception of the Organization.

Finally, the Founder argue that the contract with CO-3 is revocable because CO-3 was in breach of contract. The Founders have exercised their contractual right to void the contract. Moreover, the Founder entered into the agreement with CO-3 only if the entity formed was a supporting organization. Since it is now held that the Organization is not a supporting organization, the entire arrangement with CO-3 should be treated as if it had no effect.

Conclusion

The charitable contribution deduction taken on Founders's Form 1040 was disallowed, the Founder have depleted the bank account of the ORG (the "Organization") and the Founder have claimed the Organization should be disregarded as a sham. Accordingly, the Organization's status as an organization described under section 501(c)(3) should be revoked because it is not organized and operated exclusively for exempt purposes.

This determination is effective December 28, 20XX

200810025



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
EO: Examinations
1100 Commerce Street
Dallas, TX 75242

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Legend

ORG = Organization name

Address = address

XX = Date

ORG

Taxpayer Identification Number:
Form:
990
Tax Year(s) Ended:
December 31,
Person to Contact/ID Number:
Contact Numbers:
Telephone:
Fax:

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear :

We have enclosed a copy of our report of examination explaining why we believe an adjustment of your organization's exempt status is necessary. In addition, under separate cover, we will also be sending you a final adverse determination letter revoking your exempt status. If you have any questions, please call the contact person at the telephone number shown in the heading of this letter.

Sincerely,

Marsha A. Ramirez
Director, EO Examinations