



DEPARTMENT OF THE TREASURY

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

**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

Number: **200817042**
Release Date: 4/25/2008

January 17, 2008

LEGEND

ORG = Organization name XX = Date Address = address

UIL:501.03-01

ORG
ADDRESS

Person to Contact:
Identification Number:
Contact Telephone Number:
In Reply Refer to: TE/GE Review Staff
EIN:

LAST DATE FOR FILING A PETITION
WITH THE TAX COURT: ____

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

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 January 1, 20XX, as agreed to by you per the signed Form 6018, dated November 14, 20XX.

“Our adverse determination was made for the following reasons:”

“Organizations described in I.R.C. section 501(c)(3) and exempt under section 501(a) must be organized and operated exclusively for an exempt purpose. You have provided no information regarding your receipts, expenditures or activities. You have not established that the ORG has been operated exclusively for an exempt purpose. You have failed to meet the requirements of I.R.C. section 501(c)(3) and Treasury Regulation section 1.501(c)(3)-1(d) in that you have failed to provide information and establish that you were operated exclusively for an exempt purpose.”

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 1120.

These returns should be filed with the appropriate Service Center for the year ending December 31, 20XX, and for all years thereafter.

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: Or you can contact the Taxpayer Advocate nearest you by calling or writing to: Internal Revenue Service.

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



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service
230 S. Dearborn, Room 1790 (Attn: Fred Kluss)
MS:4923:CHI
Chicago, IL 60604

ORG
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear :

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

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

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

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

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

Letter 3618 (04-2002)
Catalog Number 34809F

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez
Director, EO 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 20XX12

LEGEND

ORG = Organization name XX = Date CO-1 = 1st company

Issues:

1. Revocation of an organization granted exemption under IRC Section 501(c)(3).

Facts:

ORG was recognized as an organization exempt under IRC Section 501(c)(3), in September of 20XX. The purpose of the organization per their organizing documents is to "receive and administer funds for the purpose of providing education to recovering alcoholics and recovering substance abuse users teaching them the way to remove, stabilize, and/or isolate barriers as well as teach them how to conduct an effective Job Search that will enable them to return as a productive member of society" (As stated in their Articles of Incorporation).

The financing of the organization per the Articles of Incorporation is to be received from contributions and faith-based initiative grants.

In the year ending December 31, 20XX, the organization reportedly received one contribution in the amount of \$ from CO-1 Investors. Further research indicates that one of the officers has ties to this company. It was later stated that the money was donated by this officer. The 990-EZ shows expenses of \$ for payments to contractors, \$ in occupancy expenses, \$ in travel expenditures, with the difference of \$ retained in the organization.

Pursuant to a third-party referral, the 990-EZ for the year ending December 31, 20XX was selected for audit. Records substantiating the contribution and expenses for the year and information regarding the third-party referral was requested from the organization. The requested records were never provided (It was indicated a former officer was holding these records and would not turn them over to the current leadership).

The third-party referral indicated that the organization submitted a loan proposal trying to secure \$ in financing to purchase, develop and execute a Lake/Land Project in (Time Share Condominiums). The proposal, dated August 31, 20XX, was written on ORG letterhead and referenced ORG as the driving source of the project. Pro Forma Financials were attached as well as details indicating that ORG had already secured a preliminary agreement to receive \$ (out of the \$ needed from the project), from an outside investor.

The third-party referral provided details indicating that independent research, showed that various statements in the loan proposal were false and/or enhanced such as the fact that the supposed investor of \$, indicated that they had no business relationship with ORG.

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ORG		20XX12

As previously indicated, this proposal was sent to the organization for comment. The organization was unable to provide details on how this proposal fit into their exempt purpose. It was also indicated that the individual who was chiefly operating the organization during the time of the proposal had died on April 17, 20XX. It was confirmed that this individual was chiefly involved with the project per the third-party referral. There, however is one other individual who was mentioned in the third-party referral, who is still involved with the organization per a current listing of officers.

The fact that the proposal is dated just before the organization was granted exemption is a point of contention. The detail of the project, suggests that the organization had to have had some indications that it was going to try to involve itself in such a business venture at the time they filed their 1023 Application. The proposal details the organization being involved in an activity that is purely commercial in nature and has no charitable basis. The fact that the proposal purportedly contained false statements is also a point of contention. The government has to insure that 501(c)(3) organizations are not used inappropriately to serve private interests. There is a concern that in this case 501(c)(3) status may have been applied for in order to enhance the organization's potential to receive loans.

Another area of concern is the lack of substantiation. Organizations are required to keep records to show that they are performing exempt activities, that the receipts of the organization are legitimate, that no expenditures are made for private purposes, and that no assets have inured or are inuring to private interests.

Based on the lack of substantiation and details surrounding the loan proposal for \$ it can only be concluded that the organization has operated in a manner inconsistent with IRC Section 501(c)(3), and that being so, their exempt status should be revoked effective January 1, 20XX.

Law:

IRC Section 501(c)(3)

This Section of the Code provides that the following organizations are exempt from taxation:

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 (h)), and which does not participate in, or intervene in (including the publishing or distributing of

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statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

Treasury Regulation Section 1.501(c)(3)-1(a)(1)

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.

Treasury 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.

Treasury Regulation Section 1.501(c)(3)-1(e)(1)

Provides that:

An organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513.

Treasury Regulation Section 1.513-1(a)

(Provides in part):

Section 513 specifies with certain exceptions that the phrase "unrelated trade or business" means, in the case of an organization subject to the tax imposed by section 511, 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 (or, in the case of an organization described in section 511(a)(2)(B), to the exercise or performance of any purpose or function described in section 501(c)(3)).

Treasury Regulation Section 53.4942(b)-1(c)

Provides that:

The term "substantially all" shall mean 85 percent or more. Thus, if a foundation makes qualifying distributions directly for the active conduct of activities constituting its charitable, educational, or other similar exempt purpose in an amount equal to at least 85 percent of its adjusted net income, it will be considered as satisfying the income test

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described in this section even if it makes grants to organizations or engages in other activities with the remainder of its adjusted net income and with other funds. In determining whether the amount of qualifying distributions made directly for the active conduct of such exempt activities equals at least 85 percent of a foundation's adjusted net income, a foundation is not required to trace the source of such expenditures to determine whether they were derived from income or from contributions.

(Insubstantial in this case is derived from the definition of "substantially all". Definitions of insubstantial noted in regulations, case law, etc. range from 5 – 15%. The translation here would be 1-15% of activity not relating to an exempt purpose would be allowable.)

Revenue Ruling 72-369, 1972-2 CB 245, indicates that an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations does not qualify for exemption under section 501(c)(3) of the Code. This revenue ruling states that providing managerial and consulting services on a regular basis for a fee is trade or business ordinarily carried on for profit.

Revenue Procedure 84-46, 1984-1 CB 541

Section 14 provides that a ruling or determination letter recognizing exemption may be revoked or modified.

The revocation or modification may be retroactive if the organization omitted or misstated a material fact, operated in a manner materially different from that originally represented, or, in the case of organizations to which section 503 of the Code applies, engaged in a prohibited transaction with the purpose of diverting corpus or income of the organization from its exempt purpose and such transaction involved a substantial part of the corpus or income of such organization. Where there is a material change, inconsistent with exemption, in the character, the purpose, or the method of operation of an organization, revocation or modification will ordinarily take effect as of the date of such material change.

Government's Position:

ORG was granted exemption under IRC Section 501(c)(3). This Code Section provides that organizations that are 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, are exempt.

Treasury Regulation 1.501(c)(3)-1(c)(1) provides that an organization will not be regarded as operating exclusively for exempt purposes, if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. (*Operational Test*)

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Treasury Regulation 53.4942(b)-1(c), as well as other code sections and court cases, provides a definition of substantially all as 85% or more. Insubstantial therefore has been determined to be anywhere from 5%-15%.

The 990-EZ states that the organization's Program Services for the year consisted of "Initial research into facilities and government compatibility with outreach program involving area communities and land development and fed land in the area as well as the review of possible land for the initial facilities location". The only documentation that has been provided to substantiate their actual activities after they were granted exemption, shows that the organization's only, primary and therefore substantial activity, was trying to secure funds to start a commercial enterprise (Time Share Condominiums in). This commercial enterprise does not fit the description of Program Services detailed on the 990-EZ. The organization in pursuing this activity failed to meet the operational test for the year ending December 31, 20XX.

Treasury Regulation 1.501(c)(3)-1(a)(1) provides that an organization must meet both the organizational test and the operational test. If an organization fails to meet either one of these tests, the Regulation provides that this organization is not exempt.

ORG not meeting the operational test, has subjected their exemption to revocation.

Treasury Regulation Section 1.501(c)(3)-1(e)(1) provides that an organization that operates a trade or business as a substantial part of their activities, is exempt, if the operation of the trade or business is in furtherance of the organization's exempt purpose.

The business that ORG attempted to engage in, is not related to the purpose for which they were granted exemption, nor is the business related to any exempt purpose specified in IRC Section 501(c)(3).

Revenue Procedure 1984-46 provides that the IRS may retroactively revoke the exemption of an organization that omitted or misstated a material fact or operated in a manner materially different than originally represented. The Procedure further provides that where there is a material change, inconsistent with exemption, in the character, the purpose, or the method of operation of an organization, revocation or modification will ordinarily take effect as of the date of such material change.

ORG's first year in operations as an exempt organization, is the same year for which it is being audited for. Thus the provisions for retroactive treatment are not relevant. However, the Procedure does provide a framework for reclassifying or revoking an organization that misstates their methods of operations. The 990 provided for the year ending December 31, 20XX provides a statement indicating what the organization's exempt purpose is, and the activities they engaged in to accomplish that exempt purpose. This exempt purpose and activities specified on the 990, does not match the activities the organization was actually shown to have engaged in. Nor has

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the organization provided evidence that its receipts and disbursements were legitimate, and did not inure to private interests.

Taxpayer's Position:

The taxpayer indicated that the board met and had initial discussions on dissolving the organization, but had some considerations on maintaining the organization if the IRS had no contention with them doing so.

Conclusion:

All the facts have been considered and it's been determined that the organization has not met the requirements for continued exemption as a 501(c)(3) organization.

Being granted 501(c)(3) status is a privilege bestowed on organizations that have charitable purposes, and activities that match those charitable purposes. ORG has not shown that there activities match the type of charitable purposes outlined in IRC Section 501(c)(3).

The organization's exempt status therefore should be revoked, effective January 1, 20XX.