



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

TE/GE: EO Examination

625 Fulton Street, Room 503

Brooklyn, NY 11201

**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

Date: January 7, 2008

Number: **200817049**

Release Date: 4/25/2008

Legend

ORG = Organization name

XX = Date UIL: 501.03-01

Taxpayer Identification Number:

ORG

Address

Person to Contact:

Identification Number

Contact Telephone Number:

**LAST DATE FOR FILING A PLEADING
WITH THE TAX COURT, THE CLAIMS
COURT, OR THE UNITED STATES
DISTRICT COURT FOR THE DISTRICT
OF COLUMBIA:**

Dear :

This is a final determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC). Recognition of your exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3) is retroactively revoked to January 1, 20XX because it is determined that you are not operated exclusively for an exempt purpose.

IRC 501(c)(3) exempts from taxation organizations which are organized and operated exclusively for charitable or educational purposes, no part of the net earnings of which inure 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 do not participate in, or intervene in, any political campaign on behalf of (or in opposition to) any candidate for public office.

We have determined that you are not operating exclusively for charitable or educational purposes. Our examination reveals that you did not operate exclusively for exempt purposes because your assets inured to, and it served the private interests of your founder and his family. You have not demonstrated that you are not operated for the benefit of your founder and his family as required by Treas. Reg. 1.501(c)(3)-1(d)(1)(ii).

We are revoking your exemption from Federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code effective January 1, 20XX.

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 all years beginning January 1, 20XX. We have secured Form 1041 returns for years ended December 31, 20XX and December 31, 20XX.

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 file a pleading seeking a declaratory judgment in the United States Tax Court, the United States Court of Federal Claims, or the United States District Court for the District of Columbia before the 91st day after the date this final determination was mailed to you. Please contact the clerk of the appropriate court for rules regarding filing pleadings for declaratory judgments and refer to the enclosed Publication 892. You may write to these courts at the following addresses:

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 too-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at: Internal Revenue Service.

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

Enclosure:
Publication 892



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY

Internal Revenue Service
5104 N. Blythe #203
Fresno, CA 93722

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.

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 886-A	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 XX = Date XYZ = State City = City
Trustee1-5 = 1st, 2nd, 3rd, 4th, & 5th trustee Promoter 1 & 2 = 1st and 2nd
promoters CO-1 thru CO-10 = 1st, 2nd, 3rd, 4th, 5th, 6th, 7th, 8th, 9th, & 10th
companies, Son-1 & 2 = 1st and 2nd son.

ISSUE:

Should ORG's Federal tax exempt status under section 501(c)(3) and 509(a)(3) of the Internal Revenue Code be revoked for failure to organize and operate exclusively for tax exempt purposes?

FACTS:

The ORG (Foundation) was created by a Trust Agreement between Founders (Grantors) and Trustee-1 Trustee-2 Trustee-3 Trustee-4 and Trustee-5 (Trustees) on December 28, 20XX. The Trust Agreement provides that the Foundation was established and at all time will be operated exclusively as a "supporting organization," within the meaning of section 1.509(a)-4(a)(5) of the Treasury Regulations. The Trust Agreement further provides that the trustees shall not perform any act or conduct any activity that is inconsistent with such status. The Trust Agreement named CO-1 as the primary supported organization. Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, named CO-2, CO-3, etc. as secondary supported organizations.

The Trust Agreement provides that governing body of the Foundation shall be five trustees appointed as follows:

- Two trustees shall be appointed by CO-1 (CO-1)
- Two trustees shall be appointed by the members of a class composed of grantors and grantors' adult descendants
- One trustee shall be appointed by CO-1 and grantors' family

The Trust Agreement provides that the Foundation shall terminate if it fails, for any reason, to qualify as a charitable foundation, contributions to which are deductible for Federal income tax purposes, Federal gift tax purposes, or Federal estate tax purposes under sections 170(c), 2522(a), or 2055(a), respectively of the IRC. Upon termination of the Foundation, the trustees shall distribute all property then comprising the trust estate, including all accumulated and undistributed income, to one or more qualified charities, for its or their general purposes.

Per Trustee-1, the Foundation was a tax avoidance scheme. A few years back when his business was doing well and he has some extra money, Trustee-1 was looking for ways to do more with his money. He became involved with CO-4 ("CO-4") (Promoter). The promoters, Promoter-1 and his partner, Promoter-2, of CO-4 offered Trustee-1 a package in which he could put money

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

away, avoid taxes and still benefit from it. Subsequently, Trustee-1 entered into an agreement with the Promoter on November 1, 20XX.

Per the terms of the agreement (Exhibit 1), the Promoter agreed to provide the following services:

- A. Prepare an analysis of various estate, tax and financial strategies and techniques that in CO-4's judgment will help the client reach his stated goals, objectives and desires.
- B. Consult with client in person and/or by telephone conference calls to review the analysis and help client select which specific strategies would be beneficial to client, and assist in the implementation of the agreed strategies.
- C. Prepare and file all documents (check where applicable) needed to implement the estate, tax and financial strategies.

- Family Limited Partnership or Family Limited Liability Company (checked)
- Supporting Organization (checked)
- Limited Liability Company (checked)
- S-Corporation
- C-Corporation
- Wills for husband and wife (checked)
- Living Trusts for husband and wife (checked)

In consideration of the services set forth above, Trustee-1 agreed to pay the Promoter a planning fee of \$ plus applicable government filing fees.

The materials provided by the Promoter obtained during the examination disclosed the following potential entities (Exhibit 2):

- ORG
- CO-5
- CO-6
- CO-7

The existence of CO-5 is to channel cash flow out of the CO-8, an S-Corporation Trustee-1 bought and owns for the last six years. CO-5 achieves this through a management contract with CO-8. The existence of CO-6 is to get the life insurance policy for Trustee-1 using the Foundation's money. Trustee-1 ended up setting up the ORG, the 509(a)(3) supporting organization, but not the others.

With respect to the ORG, the promoter, Promoter-1. of CO-4 took care of the whole process including preparing and filing Form 1023, Application for Recognition of Exemption Under

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

Section 501(c)(3) of the Internal Revenue Code, and corresponding with the Service. Promoter-1 was the contacted person listed on Form 1023. Promoter-1 was also the representative listed on Form 2848, Power of Attorney and Declaration of Representative, submitted along with Form 1023. Promoter-1 further wrote a letter to a revenue agent objecting her determination that the Foundation should be classified as a private foundation (Exhibit 3).

Per Trustee-1, all he had to do was to select four people to serve on the Foundation's board of trustees. The Promoter did not tell the Trustee-1 that one or more of these individuals must serve on the board of directors of the publicly supported organization or be selected and/or appointed by the publicly supported organizations, "*Just pick four people you can trust.*" Trustee-1 selected his neighbors to serve on the board of trustees. He told these individuals what he is doing. These board members were never involved in the Foundation. They never met to discuss the operations and activities of the Foundation. There were no minutes of meeting. Trustee-1 makes all the decision including investment and grant making decisions. The Promoter also instructed Trustee-1 to select a primary supported organization and recommended CO-1 City, XYZ.

The Promoter did not flat out tell Trustee-1 that he could use the Foundation's assets for his personal uses. However, the Promoter did hint that "*Other clients of his had done it.*" Per Trustee-1, he used the Foundation's fund to pay for his son's tuition expenses. His son, Son attended CO-1City, XYZ. In 20XX, Trustee-1 paid \$ of his son's tuition expenses using the Foundation's fund. In 20XX, Trustee-1 paid another \$ of his son's tuition expenses. These amounts were reported on Form 990 as grants and allocations distributed to primary supported organization, CO-1. His son graduated in 20XX. No tuitions were paid in 20XX. Per Trustee-1, his son also received student loans from CO-1. Per Trustee-1, tuition payments will have CO-1 as the payee on the checks. Contributions to CO-1CO-3 will have CO-1CO-3 as payee on the checks.

In addition to the tuition payments, the Trustee-1 also loaned his son \$ using the Foundation's money. There was no loan agreement. The loan is still outstanding. There was no interest charged on the loan. The loan was made on 11/3/20XX. The loan was reported on Form 990 as "Other notes & loans receivable". No required schedule describing the borrower's name, borrower's title, maturity date, repayment terms, interest rate, etc. was attached to the Form 990. In 20XX, Trustee-1 loaned \$ to another son, Son-2, using the Foundation's funds. There is a loan agreement. The loan carries an interest rate of 5 ¼ percent with monthly payment of \$. The term of the loan is 360 months. The son has been making monthly payments on the loan. The loan was made on 2/17/XX.

The Foundation's Forms 990 reflect the following:

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

	20XX	20XX	20XX	20XX
Contributions	-			
Interest on Savings	-			
Other Investment Income	-			
Total Revenues	-			
Grants & Allocations	-			
Accounting Fees	-			
Bank Charges	-			
IRS Application Fee	-			
Total Expenses:	-			
Excess (Deficit)	-			

	20XX	20XX	20XX	20XX
Cash	-			
Savings and Temporary Cash				
Investments	-			
Other Notes & Loans Receivable	-			
Investments - Securities	-			
Total Assets	-			
Liabilities	-	-	-	-
Total Liabilities	-	-	-	-

The Foundation's Forms 990 disclosed the following grant recipients for the tax years 20XX to 20XX:

Grant Recipients	20XX	20XX	20XX	20XX
CO-1 City, XYZ	-			
CO-2	-			
CO-9	-			
CO-10	-			
Total	-			

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

The following table illustrates the detail of grants that the Foundation reported on its Forms 990 as grants distributed to the primary supported organization, CO-1City, XYZ.

	20XX	20XX	20XX	20XX
- Tuition for son	-			
- CO-3	-			
-	-			
Loan to son -	-			
Other	-			
Total	-			

When the Foundation filed its Form 990 for the tax years ended December 31, 20XX and 20XX, the Foundation disclosed that it did not engage in any section 4958 excess benefit transactions. Question 89b of Part VI of Form 990 was answered "NO".

When Trustee-1 initially set up the Foundation in 20XX, he contributed \$ to the Foundation. He deducted this amount as charitable contribution deduction on his individual tax return. Since then, his S-Corp, CO-8, contributed \$ each year in 20XX and 20XX to the Foundation. He also deducted these amounts as charitable contribution deductions on his individual tax return.

Per Trustee-1, *"The whole deal was tax avoidance. There were no charitable motives involved. He listened to the promoter and bought the package. He tried to make the foundation into something better for him. He did not believe that the promoter told him all the things he needed to know about the package. He should have asked more questions before buying the package. He realized that it was wrong. He is willing to accept any proposals, including revocation and tax that the Service will come up with. He also proposed that he will terminate the foundation, pay any tax liabilities and penalties and amend his personal returns."*

LAWS:

Section 501(c)(3) of the Internal Revenue Code 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 (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

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

Section 1.501(c)(3)-1(c)(2) of the Regulations clarifies that an organization is not operated exclusively for exempt purposes if its net earning inures to the benefit of private individual.

Section 1.501(a)-1(c) of the Regulations defines "*private shareholder or individual*" as 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 states, "An organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph 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 interest such as designated individuals, the creator or his family, shareholders or the organization, or persons controlled, directly or indirectly, by such private interests."

In The Founding Church of Scientology v. United States, 412.F.2d 1197 (Ct. Cl. 1969), the court held that The Founding Church of Scientology did not qualify for exemption under IRC 501(c)(3) because its net earnings inured to the benefit of the organization's founder and members of his family.

The courts issued similar rulings in People of God Community v. Commissioner, 75 T.C. No 8 (1980); Bubbling Well Church of Universal Love v. Commissioner, 74 T.C. 531 (1980); Unitary Mission of Church of Long Island, Inc. v. Commissioner, 74 T.C. 507 (1980); Western Catholic Church v. Commissioner, 73 T.C. 196 (1979); The Basic Unit Ministry of Schurig v. U.S., 81-1 USTC S9188 (D.D.C. 1981); Church of the Transfiguring Spirit, Inc. v. Commissioner, 76 T.C. 1 (1981); and Church of Scientology of California v. Commissioner, 823 F.2d 1310 (9th Cir. 1987)

In Freedom Church of Revelation v. United States, 588 F. Supp 693, 969 (D.D.C. 1984), the court ruled that an organization operated as a part of a tax avoidance scheme do not further an exempt purpose.

Revenue Ruling 81-94, 1981-1 CB 330 held that an exempt organization operates to serve the private interest of the designated individual is not operated exclusively for religious or charitable purposes. Therefore, it does not qualify for exemption from Federal income tax under section 501(c)(3) of the Code.

GOVERNMENTS POSITION:

An organization, to be qualified as an entity described in section 501(c)(3) of the Internal Revenue Code or in certain other categories of tax-exempt organization, must be organized and operated so that no part of its net earning inures to the benefit of any private shareholder or

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

individual. The essence of the concept is to ensure that a tax-exempt charitable organization is serving a public interest and not a private interest. Section 1.501(c)(3)-1(c)(2) of the Regulations made it clear that an organization is not operated exclusively for exempt purposes if its net earning inures to the benefit of private individual. The ORG was operated exclusively to serve the private interest of Trustee-1 and his family rather than the interest of the public.

The promotion materials and the agreement Trustee-1 entered into with the Promoter, CO-4, disclosed that Trustee-1 established the Foundation to obtain tax benefits in the form of claiming charitable contribution deductions under section 170 without relinquishing control of the assets he claimed to have contributed to the Foundation. To achieve this purpose, the Promoter and Trustee-1 structured the Foundation in a way that all control and power would rest with Trustee-1. This was evidenced by the facts that Trustee-1 asked his neighbors to serve on his Foundation's board of trustees and never once informed these individuals of what he was doing with the Foundation's assets. These individuals were not associated with any of the supported organizations the Foundation claimed to support and had no obligation and/or authority to act for the interest of the supported organizations. There was no evidence that the named supported organizations were aware of the fact that the Foundation named them as the beneficiaries under the Trust Agreement. The lack of involvement from supported organizations and his absolute power and control over the activities of Foundation allowed Trustee-1 to operate the Foundation for his personal benefits including paying his son's tuition expenses and making loan that carried no interest rate and required no repayments to his sons.

Section 1.501(c)-1(d)(1)(ii) of the Regulations specifically states that an organization is not organized or operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational unless it serves a public rather than a private interest. Revenue Ruling 81-94, 1981-1 CB 330 further clarifies section 1.501(c)-1(d)(1)(ii) of the Regulations by stating that an exempt organization operates to serve the private interest of the designated individual is not operated exclusively for religious or charitable purposes. Since ORG is operated to serve the private interest of Trustee-1 and his family, it does not qualify for tax exempt status under IRC sections 501(c)(3) and 509(a)(3). Also see The Founding Church of Scientology v. United States, 412 F.2d 1197 (Ct. Cl. 1969), People of God Community v. Commissioner, 75 T.C. No 8 (1980); Bubbling Well Church of Universal Love v. Commissioner, 74 T.C. 531 (1980); Unitary Mission of Church of Long Island, Inc. v. Commissioner, 74 T.C. 507 (1980); Western Catholic Church v. Commissioner, 73 T.C. 196 (1979); The Basic Unit Ministry of Schurig v. U.S., 81-1 USTC S9188 (D.D.C. 1981); Church of the Transfiguring Spirit, Inc. v. Commissioner, 76 T.C. 1 (1981); and Church of Scientology of California v. Commissioner, 823 F.2d 1310 (9th Cir. 1987).

Furthermore, it appears that the Foundation is operated as part of a tax avoidance scheme. Tax avoidance schemes do not further an exempt purpose Freedom Church of Revelation v. Untied States, 588 F. Supp 693, 969 (D.D.C. 1984). The ORG was not operated exclusively for

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

religious, charitable, and scientific purposes. Accordingly, the Federal tax exempt status of ORG should be revoked, effective January 1, 20XX.

TAXPAYERS POSITION:

The taxpayer agreed with the government's position and has executed Form 6018, Consent to Proposed Action – Section 7428, to memorialize the present intent.

CONCLUSION:

ORG's Federal tax exempt status under IRC sections 501(c)(3) and 509(a)(3) should be revoked for failure to operate exclusively for charitable, religious, and scientific purposes. The effective date of this revocation will be January 1, 20XX.