DEPARTMENT OF THE TREASURY
Internal Revenue Service
TE/GE EO Examinations
1100 Commerce Street
Dallas, TX 75242

TAX EXEMPT AND GOVERNMENT ENTITIES DIVISION

January 24, 2008

Number: **200817055**
Release Date: 4/25/2008

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. You have agreed to this adverse determination, per signed Form 6018, on April 19, 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. Your organization did not engage in any charitable activities and your assets were transferred to the Founders' business in a series of transactions and the organization received nothing from the transfer. Your organization is not a charitable organization within the meaning of Treasury Regulations section 1.501(c)(3)-1(d). You have not established that you have operated exclusively for an exempt purpose.

You failed to meet the requirements of IRC section 501(c)(3) and Treas. Reg. section 1.501 (c)(3) -1(d) in that you failed to establish that you were operated exclusively for an exempt purpose. Rather, you were operated for the benefit of private interests and a part of your net earnings inured to the benefit of disqualified members.

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 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.

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
1100 Commerce Street
Dallas, TX 75242

Taxpayer Identification Number:

ORG
ADDRESS

Form:
990
Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:
Telephone:
Fax:

Certified Mail - Return Receipt Requested

Dear :

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

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

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

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

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

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

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

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

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez
Director, EO Examinations

Enclosures:
Publication 892 & 3498
Form 6018
886-A

LEGEND

ORG = Organization name XX = Date XYZ = State City = city Address = Address Country = Country Agent = agent Founders = founders Founder-1 & 2 = 1st, 2nd founder, BM1-3 = 1st, 2nd, 3rd board members CO-1-21 = 1st, 2nd, 3rd, 4th, 5th, 6th, 7th, 8th, 9th, 10th, 11th, 12th, 13th, 14th, 15th, 16th, 17th, 18th, 19th, 20th, 21st companies.

ISSUE:

The ORG ("CSO") was established as an integral component of an arrangement called the Master Financial Plan. It was designed specifically for Founders by a now-defunct tax shelter promoter primarily to provide the Founders the maximum income tax avoidance, asset protection and estate planning benefits they sought. Under such circumstances, described in greater detail herein, is CSO operated exclusively for purposes described in section 501(c)(3) of the Internal Revenue Code?

FACTS:

1. **Entities participating in and/or created to implement the Master Financial Plan**

   a. **Affiliated Entities of CO-1 – the Promoter**

   The promoter and all affiliated entities, listed below, have come under Federal investigation by the Securities and Exchange Commission ("SEC"), Federal Bureau of Investigation and the Internal Revenue Service ("Service") for promoting numerous tax shelter schemes involving offshore transactions, including the repatriation of funds in the form of tax-free borrowing. The CO-1 entities are as follows:

   (1) CO-1., ("CO-1"), was a company, headquartered in Country. CO-1 claimed to be a leading firm in the business of providing tax reduction and asset protection through the establishment of offshore entities and accounts. It was organized as a parent company, charged with coordinating the actions of its subsidiaries, as well as CO-2, an affiliated law firm.

   (2) CO-1, Inc., ("CO-1"), was a XYZ corporation, incorporated in 19XX. CO-1's function was to provide the office space and the staff who provided services to CO-1 and its investors, and served as the office through which investors are solicited. CO-1 and CO-1 also regularly induced clients to purchase securities, including those issued by CO-4 and CO-3. CO-1 was located in City, XYZ.

   (3) CO-3., ("CO-3"), was a entity that acted as an investment adviser and a "mutual fund company" for CO-1 investors. CO-3 managed "mutual funds" that

had been sold to CO-1 investors. It also maintained accounts with brokerage firms into which investor securities were placed.

(4) CO-4, ("CO-4"), was an entity organized under the laws of Country, a Country . CO-4 ostensibly acted as an issuer of many of the investment products (e.g., LOI insurance policies) sold to CO-1 investors. CO-4 also controlled the funds of CO-1 investors that were to be repatriated to those individuals from accounts located in the Country.

(5) CO-2, Ltd., ("CO-2"), was a entity and a State of XYZ limited liability company. CO-2 was an international legal firm that operated as CO-1's legal advisors. It also shared offices with CO-1 in Country, Country and CO-1 in City, XYZ. CO-2's legal tax opinion, supporting the legality of the Master Financial Plan, was used by CO-1 to solicit wealthy clients.

(6) CO-5, ("CO-5"), was an arm of CO-1 and was based in Country, Country. CO-5 was set up to receive wire transactions from investors at an account it established with the CO-6. It was also used to facilitate the repatriation of client funds via an Equity Management Mortgage.

(7) CO-7("CO-7"), was a State of XYZ Limited Liability Company used to facilitate the repatriation of client funds via an Equity Management Mortgage.

b. <u>Affiliated Entities of Founders – the Clients</u>

(1) The ORG, ("CSO"), is a non-profit corporation formed in the State of XYZ on or about December 27, 20XX. CSO is an integral component of the Founders Master Financial Plan.

(2) CO-8., ("CO-8"), was an international business corporation formed and located in the Country. CO-8 is an integral component of the Founders Master Financial Plan.

(3) CO-9., ("CO-9"), was a hybrid company formed and located in Country. CO-9 is an integral component of the Founders Master Financial Plan.

(4) CO-10, ("CO-10"), was a limited liability company formed in the State of XYZ. CO-10 is an integral component of the Founders Master Financial Plan.

(5) The CO-11, ("CO-11"), is a trust formed in the State of XYZ. CO-11 is an integral component of the Founders Master Financial Plan.

(6) CO-12, ("CO-12"), is an S corporation formed in the State of XYZ in t he late 19XXs by Founder-1 who also is CO-12's sole owner.

(7) CO-13, ("CO-13"), is an S corporation formed in the State of XYZ by Founder-1 who is also CO-13's sole owner.

c. **Supported Organizations – the entities CSO supports**

(1) CO-14 is an IRC 501(c)(3) organization that was named the primary beneficiary. Every year, it conducts a fundraising golf tournament in the name of CO-14 for the sole benefit of CO-15 of CO-13, Inc.

(2) CO-16 is an IRC 501(c)(3) organization that was named a secondary beneficiary. It exists to find cures for CO-16 and related diseases by providing hope and support for affected individuals and their families through research, advocacy and awareness of these devastating diseases.

(3) CO-17 (dba "CO-17") is an IRC 501(c)(3) organization that was named the secondary beneficiary. It provides support programs, education and resources, free of charge, to benefit young adults, their families and friends, who are affected by , and to promote awareness and prevention of .

(4) CO-18 is an IRC 501(c)(3) organization that was named the secondary beneficiary. It strives to eliminate domestic violence in by providing shelter, counseling, legal assistance, and advocacy; by increasing community awareness; and by changing societal attitudes.

2. **Background**

a. **Promotion and Design of the Master Financial Plan**

On or about June 16, 20XX, Founders contacted CO-1 to discuss income tax reduction, asset protection and estate planning arrangements. During the initial call, Founder-1 indicated that he was beginning an offshore venture with a Country citizen and would like to structure everything in a tax efficient manner. Later that month, however, Founder-1 decided to discontinue his dealings with CO-1 until later that summer.

By late September, Founder-1 resumed his inquiry with CO-1. Before a Master Financial Plan could be devised, the Founders were required to submit their history. The information they were asked to provide included personal data (e.g., name, address, citizenship, family data, and employment); goals & objectives (e.g., objectives, priorities, description of "perfect situation," estate planning); personal assets, liabilities, income and expenses; business history, assets and liabilities); and a list of advisors.

According to the information he submitted, Founder-1 is a business owner in the State of XYZ. He is the sole owner of CO-12, a State of XYZ S-Corporation he started in the late 19XXs. CO-12's primary business is the sale of adjustable beds. It employs approximately 50 people. Both Mr. and Founder-2 are corporate executives at CO-12.

In describing his "perfect situation" over specified time frames, Founder-1 wrote the following:

Time Frame	Description of where you want to be or your "perfect situation"

1 to 5	Reduction in taxes. Financially secure so do not need to work full time.
5 to 10	10 years – Retired. College education covered. House paid off.

When instructed by CO-1 to rank the following objectives by importance, on a scale of 1 to 10 where 1 equaled very important and 10 equaled unimportant, the Founders assigned the following values:

Income Tax Reduction	1
Capital Gain Tax Reduction	6
Creating a Family CO-7 – Estate Tax Reduction/Elimination	5
Asset Protection	2
Increase Net Worth	2
Maximize Income	1
Participation in Charitable Causes	5
Retirement Exit Strategy	5
Utilizing Off-Shore Strategies Control	?

With respect to offshore strategies, the Founders indicated that they their knowledge and expertise was limited but would feel comfortable using such strategies to minimize tax. Their overall objective in contacting CO-1 was to reduce taxes.

In late September, Founder-1 resumed his discussions with CO-1. The discussions resulted in a plan projected to save the Founders at least $ with CO-1 potentially earning a fee of $ and maintenance fees between $ and $ thereafter. On or about October 16, 20XX, Founder-1 paid the initial planning fee of $.

On or about December 6, 20XX, the Founders traveled to XYZ to view the CO-1 presentation at the CO-1 office in City. At the presentation, CO-1 officials presented the Master Financial Plan designed according to the Founders' financial circumstances. The financial objectives of the plan were: (1) Income Tax Reduction; (2) Income Maximization; (3) Asset Protection; (4) Net Worth Enhancement; and (5) Estate Tax Reduction.

The plan strategies required the Founders to implement the following strategies: (1) Loss of Income Progam; (2) Welfare Benefit Plan with VEBA Trust; (3) Support Organization; (4) Equity Management Mortgage; and (5) Decontrolled Foreign Environment. Several of these strategies are discussed in greater detail below.

Based on the following income assumptions, full implementation would yield the following tax savings for the tax year ending December 3, 20XX:

	No	SO Only	SO Only	LOI Policy	VEBA Only	Full

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 Thru 20XX**

Description	Implementation	50% AGI Only	Implementa
Income			
W-2			
W-2			
Rental Income			
Interest			
S-Corp Distributions			
Total Income			
Less:			
Self Employment Taxes			
IRA Deduction			
Adjusted Gross Income			
Itemized Deductions			
State Income Taxes			
Property Taxes			
Home Mortgage Interest			
Charitable Contributions			
3% AGI Floor			
Total Itemized Deductions			
Less:			

Personal Exemption	
Taxable Inome Per 1040	
Tax Costs	
Federal Income Tax	
State Income Tax	
Alternative Minimum Tax	
FICA/Medicare Tax	
Total Tax	
Tax Savings	
Percentage Saved	

b. <u>SEC Description of the Master Financial Plan</u>

In its complaint against CO-1, the SEC stated that CO-1 offered a product known as a Master Financial Plan whose function is to provide a means by which the investor can invest cash and securities offshore, usually in the Country or another Country nation, and receive tax-free gains from the investment activity. The basic structure of the plan involves the transfer of an investor's income and/or assets into offshore entities established on behalf of the investor. These funds and assets are then used to purchase investment and other products offered by CO-1 and its affiliates. The Master Financial Plan also provides investors a means to repatriate assets through transactions that hide the actual ownership of the assets, thereby enabling the investors to utilize the untaxed funds without paying tax obligations. For instance, in its sales manual, CO-1 states:

> *Once money is invested offshore, there are several ways to repatriate part or all of it. These include such non-taxable methods as with secured credit cards, personal or corporate loans, mortgages, personal withdrawals or through insurance policies. Capital can also be repatriated through taxable means such as through salaries or annuities.*

CO-1 promises its clients that, through the implementation of the Master Financial Plan, the clients will reduce their taxes by significant percentages, have their investments grow offshore in a tax free environment, and will be able to protect their assets from unwanted liabilities and encumbrances.

The SEC contends that the Master Financial Plan essentially establishes the framework through which the CO-1 investor invests and protects cash and assets, avoids payment of taxes and repatriates his or her funds.

c. Description of the Founders Master Financial Plan

CO-1 designed the Master Financial Plan to further the income tax reduction, asset protection and personal estate planning objectives of Founder-1. It involved the establishment of several offshore and domestic entities; the purchase of several insurance plans; and the execution of transactions through which Founder-1 invested his pre-tax income.

The types of entities employed by CO-1 included International Business Corporations (IBCs), Voluntary Employee Beneficiary Associations (VEBAs), Support Organizations (SOs), S Corporations (S Corps) and Limited Liability Companies (LLCs). The insurance arrangements included products such as Loss-of-Income (LOI) insurance policies and Foreign Variable Annuities ("VFA").

(1) Description of Component Entities

(a) International Business Corporations

The SEC report stated that CO-1 sales literature described IBCs as corporations formed in a tax haven but not authorized to do business within that country. They are intended to be used as an investment or asset protection vehicle. The CO-1 investor transfers personal assets or an investment portfolio to the IBC.

CO-1 tells clients the offshore entities are not owned or controlled by the clients for tax purposes. Rather, nominee officers or directors act on behalf of the clients to control the entities and effect transactions. In fact, CO-1 personnel have authority to effect the transactions, retaining sole signatory authority over all accounts. Typically, in order to affect a transfer of funds, senior personnel at CO-4 or CO-3 must authorize the transfer.

(b) Supporting Organizations

SOs are described as charitable organizations established for the benefit of an individual client. Among the stated benefits of an investor establishing an SO over using a domestic charitable organization is that investment funds transferred to the investor's personal SO can grow tax free. These investment gains are available to the donor/investor through access to the offshore corporations that manage the investments of the SO.

CO-1 states that Founder-1, as CSO's trustee, is able to make investment decisions, including the ability to borrow indirectly from the contributed funds, and direct charitable contributions, giving them a high degree of control over the donated assets. In addition, salaries and other

administrative expenses may be paid to Founder-1 and/or their family members in the approximate amount of 25 percent of the CSO's gross income.

(c) Voluntary Employee Beneficiary Association

CO-1 defines a VEBA as an employee benefit program that permits employers to take tax deductions for certain employee benefits payments such as the payment of life, sick, accident, death or other benefits. The investment gains of these payments grow tax deferred. Under certain circumstances, the gains can be accessed tax-free; e.g., borrowing funds to pay for the children's college education through a VEBA trust.

(d) S-Corporation

The S-Corporation model is also used to implement the VEBA and requires at least two employees. Under the VEBA arrangement, the employees would join the union and the employer would contribute tax deductible premiums to the VEBA trust. If the insurance policy accumulates cash value, the trust that administers the arrangement can issue loans to participants if certain conditions are met, viz., (1) paying uninsured medical expenses; (2) paying for post-secondary education of dependents; and (3) unusual, unexpected hardship events. Although repayment is anticipated, any outstanding loan balances at death can be paid off by the death benefit.

(e) Limited Liability Company

A Limited Liability Company offers personal protection and tax savings but does not require the reporting and record keeping of a corporation.

(2) Description of Insurance Products

The types of investment products sold by CO-1 include Loss of Income Policies ("LOI"), Equity Management Mortgages ("EMM") and Foreign Variable Annuities ("FVA"). The Founders implemented LOI and FVA.

(a) Loss of Income Insurance Program

A Loss of Income policy ("LOI") is an agreement between the CO-1 client and CO-4 whereby the client purchases a policy to insure against a future loss of income.

An LOI policy is usually purchased for coverage until the earlier of a specified term, such as 1 year, or the date of death of the insured. The insurance company typically holds the net premium in a separate account, along with the net premiums of other LOI insurance policies. Creditors cannot access policy reserves. The insurance company guarantees a fixed return on such premiums. Most LOI policies provide that your premiums, plus a guaranteed return, will be paid back to the policy holder at the end of a specified period (usually 10 years).

The sales manual also states that investment decisions are made by the insurance company. The funds received by CO-4 for the sale of LOIs are pooled in an account at CO-19 maintained by CO-4 in the Country.

SEC contends that, in reality, LOIs are not purchased as insurance, but as a vehicle to make offshore and tax-free investments of funds which can be repatriated as desired by the investor. No CO-1 investor has ever filed a claim against an LOI for a loss of income. What, in fact, occurs is that the investor purchases the LOI from CO-4 and then borrows back a percentage of the premium through a note or investment contract, usually in the form of a "mortgage," called an Equity Management Mortgage or EMM.

The EMM is obtained through two affiliated entities of CO-1, CO-5 and CO-7, which act as the mortgagee. The investor's proceeds from the EMM are then placed in an IBC and invested offshore through CO-3, or repatriated by the investor. The net effect of the LOI/EMM transaction is that the investor (S-Corporation) is able to deduct the premium paid for the LOI, encumber his property through a mortgage to himself and deduct the interest payments to himself on the mortgage. The investor can then invest the proceeds from the mortgage offshore through an IBC, with CO-3 managing the investment. The remainder of the premium left with CO-4 is then invested to provide the investor with a fixed rate of return over the ten-year life of the policy.

(b) Foreign Variable Annuities

The FVA is a variable annuity issued by CO-4. The investor purchases the FVA by transferring cash or securities to CO-4; CO-4 then pays the investor or his designees the principal and an agreed upon rate of return over the succeeding years. CO-1 markets the FVA as a means to repatriate a client's assets without tax consequences. With respect to FVAs the CO-1 sales manual states:

> *You could purchase a Foreign Variable Annuity Contract between you and a Foreign Insurer. During the accumulation period of the Annuity Contract you could set aside money and have it grow on a tax-deferred basis [pending] withdrawal. At retirement, or another time selected by you, the payout period begins whereby the insurance company promises to pay a steady stream of income for a fixed period of time or for life.*

d. Implementation of CSO

On or about December 27, 20XX, Founders established the ORG in the form of an irrevocable trust. Pursuant to the organizing document, the trust was organized and operated exclusively to support or benefit one or more publicly supported organizations as defined by TR 1.509(a)-4(b)(1).

On or about December 28, 20XX, the Founders contributed $ to CSO for which they claimed a charitable contribution deduction under IRC 170. During several phone consultations that occurred in January 20XX, Founder-1 indicated that he wanted to obtain a corporate loan from CSO, giving CSO a 5 percent annual rate of return. Founder-1 wanted to facilitate the loan through CO-5 into CO-13, his finance company.

Pursuant to Founder-1's objective, an investment agreement was signed between CSO and CO-5 sometime in January 20XX. The agreement authorizes CO-5 to:

(a) Hold, invest and reinvest the assets at CSO's risk, at such times and in such manner as CO-5 shall determine;

(b) Hold all or any part of the investment account uninvested for such period of time as CO-5 shall determine;

(c) Vote in person or by proxy shares of stock or other securities in such manner as CO-5 shall determine;

(d) Hold the assets in the name of CO-5' nominee; and

(e) Sign CSO's name to any stock certificate, bonds or other securities registered in CSO's name in order to sell them or transfer them to the name of CO-5's nominee.

At the end of the investment agreement, 5 years from the agreement's execution date, CO-5 is required to return the principal amount plus interest at a rate of 5 percent per annum. But CO-5 can pay CSO a lesser rate of return if it cannot earn 5 percent.

On or about March 22, 20XX, CSO wire transferred the $ offshore to CO-5 in the Country. The funds were deposited in CO-5's account at the CO-6. The funds were then wire transferred to CO-7 on or about March 26, 20XX. CO-7, in turn, issued a corporate loan in the amount of $ to CO-13 and guaranteed by Founder-1. Interest was charged at a rate of 15 percent per annum on unpaid principal until the full amount of the principal has been repaid. The effective loan date is April 1, 20XX. An annual payment was due on the 31st day of every December beginning December 31, 20XX.

For the year ended December 31, 20XX, CO-7 was due $ of which $ was payable to CSO. Thereafter, CSO was due $. CSO, however, did not receive any interest payments. CSO, instead, terminated operations in 20XX. Further, the Service disallowed the $ charitable contribution deduction the Founders claimed on their 20XX personal income tax return.

e. Application for Exemption Status

CSO's Form 1023 application for exemption was prepared and submitted to the Service by CO-2. The Service received the Form 1023 on May 9, 20XX. Pursuant to the application, CSO's purpose is to distribute substantially all of its income to and for the use of various public charities and to help the CO-14 ("Primary Charity") carry out its purposes and perform its functions. In addition of Primary Charity, CSO lists the following charities as supported organizations:

(2) CO-16;

(3) CO-17;

(4) CO-20; and

(5) CO-21

Each year at least 35 percent of the adjusted net income is to be distributed to Primary Charity and at least 50 percent is expected to be distributed to the remaining supported organizations, as determined by the board. In total, at least 85 percent of the adjusted net income will be distributed among designated public charities.

The initial board of directors is comprised of the following persons:

- Founder-1, Founder and Trustee
- Founder-2, Founder
- BM-1
- BM-2
- BM-3, CO-14

The application provides that the board of directors includes a member appointed by Primary Charity and will work with the governing board of 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 Primary Charity.

Although CSO's primary source of financial support is Founders, CSO's board of directors plans to fully sponsor and support an annual fund raising golf tournament to assist Primary Charity in raising funds for other programs.

The declaration of trust does not indicate that the majority of CSO's board is to be elected or appointed by the supported organizations. Rather, section 3.1.1 of the trust provides that only one member of the board of directors may be appointed by Primary Charity. There are no appointments from the secondary supported organizations.

The Service issued a favorable determination letter to CSO on June 11, 20XX recognizing it as an organization described in section 509(a)(3) of the Code.

3. Form 990

CO-1 prepared CSO's calendar years 20XX Form 990. CSO reported the following amounts of revenue and expenses on its Form 990:

	20XX	20XX	20XX	20XX	20XX
Revenue -					
Direct Public Support	$				
Interest on savings and temporary cash Investments					

Total Revenue	$
Expenses -	
Program Services	$
Management and general	$
Fundraising	$
Payments to affiliates	$
Total Expenses	$
Excess or (deficit) for the year	$
Nets assets at beginning of year	$
Other changes in net assets	$
Net assets at end of year	$

On its Form 990, CSO stated that its primary exempt purpose is to distribute substantially all of its income to and for the use of various public charities, including the primary charity. CSO did not make any grants in calendar year 20XX and terminated operations the succeeding calendar year. When the Service contacted CSO in 20XX, the Founders power of attorney indicated that they would like to terminate CSO's exemption status.

4. SBSE Examination.

SBSE audited Founders's 1040 return for 20XX. Revenue agent conducting examination was Agent. As a result of Agent examination, the $ charitable deduction taken by the Founders was denied. Form 4549, "Income Tax Examination Change" calculating corrected tax liability is signed and submitted to the Founders on 5/2/20XX. The Founders consented to the denial of their charitable tax deduction by signing Form 4549 on 5/31/20XX. The Founders pay the additional tax and interest related to this correction on July 19, 20XX.

LAW:

Internal Revenue Code ("IRC") section 501(c)(3) of the 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.

Treasury Regulation ("TR") 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.

TR 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.

TR 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.

In Better Business Bureau v. United States, 326 U.S. 279 (1945), the United States Supreme Court held that regardless of the number of truly exempt purposes, the presence of a single substantial non-exempt purpose will preclude exemption under IRC section 501(c)(3).

In Founding Church of Scientology v. U.S., 412 F. 2d 1197 (Ct. Cl. 1969) the court stated that loans to an organization's founder or substantial contributor can constitute inurement that is prohibited under section 501(c)(3). In that case, the church made loans to its founder and his family and failed to produce documentation that demonstrated that the loans were advantageous to the church. The church also failed to produce documentation to show that the loans were repaid. Significantly, the court stated that "the very existence of private source of loan credit from an organization's earnings may itself amount to inurement of benefit."

In Revenue Ruling 67-5, 1967-1 C.B. 123, it was held that a foundation controlled by the creator's family was operated to enable the creator and his family to engage in financial activities which were beneficial to them, but detrimental to the foundation. It was further held that the foundation was operated for a substantial non-exempt purpose and served the private interests of the creator and his family. Therefore, the foundation was not entitled to exemption from Federal income tax under IRC section 501(c)(3).

Tax Payer Position:

Per the legal counsel for CSO, the were taken in by a group of unscrupulous businessmen. The Founders sought honest advice regarding tax planning. At that time, the Founders did not have an accountant. They came across CO-1 by way of an advertisement in a magazine. The Founders relied on CO-1, as they held themselves out to be experts in the area of

tax and tax law. The Founders, having little experience or background in these areas, put their trust in these apparent experts and relied on their advice. In hindsight, the Founders feel that they were duped by dishonest accountants and lawyers. The Founders do not take issue with the facts as they are stated in this document. Furthermore, they are willing to accept revocation of CSO.

GOVERNMENT'S POSITION:

The Service is proposing to revoke the exemption status of CSO, because CSO is not operated exclusively for exempt purposes as defined under IRC section 501(c)(3).

The facts herein show that CSO is not operated exclusively for an exempt purpose. Rather, CSO was established as an integral component of an abusive arrangement that promised to provide the Founders income tax reduction, asset protection and personal estate planning – a substantial nonexempt purpose in contravention of IRC section 501(c)(3). See Business Bureau v. United States, 326 U.S. 279 (1945).

One factor supporting the Service position is the hidden purpose for which CSO was organized, viz., tax avoidance and asset protection. For instance, the promotion material stresses the tax benefits the Founders could potentially realize from setting up an SO. The tax advantages listed include avoidance of the excise taxes, the distribution and the self-dealing rules private foundations are subject to; a larger percentage (50%) of the gift is deductible by the donor (by contrast, gifts to private foundations are limited to 30% of the donor's adjusted gross income); and avoidance of capital gains on gifts of property.

In furtherance of such hidden purposes, the Founders contributed cash in the amount of $ to CSO, claiming a charitable contribution deduction on the Schedule A of their 20XX Form 1040 income tax return. The funding of the gift was determined by CO-1 in a prearranged plan to obtain the maximum income tax deduction for the Founders.

While there is nothing inherently cynical about planning one's financial affairs to minimize the amount of tax owed, the gift was made to complete the first step of an arrangement to transfer the funds offshore beyond the scope of the Service, only later to be repatriated to CSO, after the Founders realized the full tax benefits of their Master Financial Plan.

After receiving the gift, CSO wired transferred $ to an offshore account controlled by CO-5 at the CO-6 in the Country where the amount was then repatriated to the United States in a wire transfer to CO-7, a State of XYZ limited liability company controlled by CO-1. CO-7, in turn, loaned the $ to CO-13, a State of XYZ S-Corporation solely owned and controlled by the Founders.

To effect a charitable contribution, the Founders would have had to relinquish control over the donated funds, but they instead chose to retain control over investment decisions while directing the disposition of the charitable assets. CO-1 describes the exploitation of an SO as a conduit for tax-free investing offshore as a secondary but significant use. Once captured in an offshore

environment, the assets can be made available for offshore tax-free investing or other business purposes. The investment gains are accessible to the donor through IBCs and domestic entities, created to manage the investments of CSO and hide the repatriation of funds to the donors.

Since CSO's formation in December 20XX, no funds have been distributed to any of the supported organizations listed above. In fact, no distributions have been made at all. This is due to the fact that CSO did not receive any interest income in 20XX or in any subsequent period. CSO did not receive interest income simply because Founder-1 did not make any interest payment as required by the loan agreement and CO-7 failed to enforce the terms of such agreement. In 20XX, CSO reported $ in income and no expenses. CSO also stopped filing Form 990 after 20XX, the first year it filed. In 20XX, the Founders contributed $ but CSO returned the contribution shortly afterwards and the Founders did not report the gift on its 20XX personal income tax return. In subsequent years, CSO did not engage in any activities. In essence, after realizing the tax benefit from the contribution, the Founders had no further use for CSO. Thus, CSO is a sham, devoid of substance, operating exclusively for the Founders personal benefit.

The promotion materials contains little substance in describing supporting organizations, e.g., how such organizations are operated within the requirements of the Federal tax laws and regulations, charitable purpose and an understanding of the problems an SO seeks to address, recordkeeping and filing requirements, differences between supported organizations, etc. Moreover, the promotion materials do not contain any basic information on how to maintain the SO after it is created, e.g., achieving the mission, creating a business plan and budget, bookkeeping, accounting systems, setting up a bank account, etc.

CSO is operated as part of a tax avoidance scheme. Tax avoidance schemes do not further an exempt purpose. Freedom Church of Revelation v. United States, 588 F. Supp 693, 696 (D.D.C.1984). CSO is is operated to enable the Founders to engage in financial activities which are beneficial to them and/or entities with whom they are transacting business, but detrimental to CSO. Accordingly, it is operated for a substantial non-exempt purpose. See Revenue Ruling 67-5.

Even if the hidden purpose did not exist, CSO would fail to be operating exclusively for an exempt purpose. For instance, the Tax Court held that where organization's primary activity was (1) the passive investment of its funds and accumulating income therefrom; (2) did not engage in activities to further its exempt purpose; and (3) some of the financial transactions benefited private interests, then it was not operated exclusively for an exempt purpose and it has not shown that no part of its net earnings inured to the benefit of private individuals. See Western Catholic Church v. Commissioner, 73 T.C. 196, 214 (1979), aff'd 631 F.2d 736 (7th Cir. 19XX).

The Service traced the $ charitable contribution from its source to its final destination and determined the flow to be circular, resulting in CSO's net earnings inuring to the benefit of the Founders. TR section 1.501(a)-1(c); Ginsburg v. Commissioner, 46 T.C. 47 (1966). The very presence of a private source of loan credit may constitute inurement. Founding Church of Scientology v. United States, 412 F.2d 1197 (Ct. Cl. 1969); Church in Boston v. Commissioner,

71 T.C. 102 (1978). See also Best Lock Corporation v. Commissioner, 31 T.C. 1217, 1235-37 (1959) where the Tax Court held that loans to disqualified persons promote private rather than charitable purposes.

CONCLUSION:

The Service proposes to revoke the exemption status of CSO, effective January 1, 20XX. The Service's proposal is based on the results of its compliance examination, which covered CSO's tax years, December 31, 20XX through December 31, 20XX. The examination concluded that CSO was organized and operated as an integral component of an offshore tax avoidance and asset protection scheme that promised to reduce income taxes, obtain tax-free income from offshore investments, and provide asset protection from unwanted liabilities and encumbrances. This scheme benefited CSO's founders, Founders, more than incidentally – a violation of IRC 501(c)(3).

Accordingly, CSO's status as an organization described under IRC section 501(c)(3) should be revoked , effective January 1, 20XX, because it did not operate exclusively for exempt purposes because its assets inured to, and it