

Department of Treasury
Internal Revenue Service

Release Number: 200850038

Release Date: 12/12/08

Date: 9/18/08

ORG = Organization name XX = Date Address = address
LEGEND

UIL:501.03-01

ORG
ADDRESS

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

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

Dear

This is a Final Adverse Determination Letter as to the ORG's exempt status under section 501(c)(3) of the Internal Revenue Code.

Our adverse determination was made for the following reasons:

Organizations exempt from Federal income tax under section 501(c)(3) of the Code are required to operate exclusively for charitable, educational, or other exempt purposes. Organizations are not operated exclusively for exempt purposes if the net earnings of the organization inure in whole or in part to the benefit of private shareholders or individuals of the organization. See Treas. Reg. section 1.501(c)(3)-1(c)(2). You did not operate exclusively for charitable purposes because net earnings inured to the benefit of individuals having personal and private interests in the activities of your organization; you operated for purposes serving private interests; and you failed to maintain sufficient records to demonstrate that you operated exclusively for exempt purposes. Public records show that your corporate rights, powers and privileges have been suspended by state authorities and you provided a written statement to the Internal Revenue Service that you were "inactive" during 20XX. The funds inuring to individuals were substantial in comparison to activities furthering exempt purposes. You did not or have not implemented appropriate safeguards to prevent recurrence. As such, you have not operated exclusively for exempt purposes and have operated for the benefit of the private interests of private shareholders or individuals of your organization in contravention of the requirements of Treas. Reg. section 1.501(c)(3)-1(d)(1)(ii).

Based upon these reasons, we are retroactively revoking your IRC section 501(c)(3) tax exempt status to 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 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 writing to: Internal Revenue Service, Taxpayer Advocates Office.

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,

Vicki L. Hansen, Acting,
Director, EO Examinations

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule
Name of Taxpayer ORG		Year/Period Ended 20XX12

LEGEND

ORG = Organization name XX = Date Address = address City = city
 XYZ = State County = county President = president Secretary =
 secretary Treasurer = treasurer PER-1 & PER-2 = 1st & 2nd PER BM-1
 through BM-7 = 1st, 2nd, 3rd, 4th, 5th, 6th, & 7th BOARD MEMBERS CO-1 THROUGH
 CO-11 = 1ST, 2ND, 3RD, 4TH, 5TH, 6TH, 7TH, 8TH, 9TH, 10TH & 11TH COMPANIES

ISSUES:

1. Should the Section 501(c)(3) exemption ruling issued to ORG (hereinafter the "ORG") be revoked because its operations served private interests of its founders and insiders and conferred impermissible inurement on its insiders?
2. Should the Section 501(c)(3) exemption ruling issued to ORG be revoked because it failed to keep records to show that its operations serve the intended charitable beneficiaries and because it also failed to observe the annual filing of information returns Forms 990 as required from organizations exempt under Internal Revenue Code (IRC) 501(c)(3)?

OVERVIEW:

During the years 20XX through 20XX ORG was engaged in housing activities. It purchased and resold at least 17 properties it obtained from HUD at a discount based on its status as a non-profit agency committed to providing low cost adequate housing to poor people. ORG has not limited its operations to buyers who are members of the intended charitable class and it did not require or obtain proof of low income status from its buyers. Two of its officers and directors benefited from the organization's charitable program, namely, the organization provided them low cost adequate housing. During their tenure the organization became a non-filer of Forms 990 and participated in irregular and questionable real estate transactions.

FACTS

Organization and History of ORG

CO-1 (hereinafter "CO-1") incorporated in XYZ on May 14, 19XX for the purpose of providing low cost adequate housing to XYZ disadvantaged minority community members who are poor and distressed and provide opportunities for said people to own and operate businesses and develop entrepreneurial skills.

The Articles of Incorporation provided that the organization will be organized and operated exclusively for charitable purposes within the meaning of 501(c)(3); those dedicated the property of CO-1 to charitable purposes and provided that no part of its net income or assets shall ever inure to the benefit of any director, officer or member thereof or to the benefit of any private person. Upon dissolution CO-1 assets were to be distributed to another 501(c)(3) exempt organization. CO-1 applied to IRS for exemption on 7/16/19XX and received IRS ruling under Internal Revenue Code (IRC) Sections 501(c)(3), 509(a)(1) and 170(b)(1)(A)(vi) on Aug. 7, 19XX. IRS letter 1050 dated Oct. 21, 20XX notified the organization that based on the information supplied IRS has determined it is a public charity under 509(a)(2).

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CO-1 changed its name to: ORG¹ on Feb. 2, 20XX.

ORG corporate status has been suspended by the XYZ Secretary of State on Aug. 20XX. On Dec. 27, 20XX the XYZ Attorney General sent a letter to ORG warning the entity that unless it files the required Annual Registration for years 20XX through 20XX and files IRS form 990 for years 20XX through 20XX its exemption will be disallowed.

Directors and Officers' Tenure on ORG Board

When ORG applied for exemption with IRS on July 16, 19XX, its officers were President, Secretary, and Treasurer. Subsequently, a rift developed among ORG directors and was resolved by the Superior Court of the State of XYZ for the County. The parties filed a statement with the Court that stated that BM-1, BM-2, BM-3, President, BM-4, and BM-5 were directors of ORG on Jan. 12, 20XX. On March 26, 20XX the court decreed that ORG board of directors shall consist of BM-1, BM-2 and BM-3. BM-1 stayed active on the Board; she represented the ORG during IRS examination.

Notable Board Resolutions:

Minutes of June 19XX stated that Secretary is the organization's Secretary².

Minutes of Sept. 28, 19XX- stated that BM-1 is Director-Real Estate Operations.

The minutes of May 26, 20XX stated that BM-1 is Assistant Secretary. These minutes authorized to borrow \$ from CO-2 for the purchase of a 20XX Mercury Villager.

The minutes of July 1, 20XX stated that BM-1 became the signatory authority to open a credit line and/or bank account for ORG.

The minutes of Feb. 24, 20XX- authorized the payment of salaries for services to BM-1, BM-2 and Secretary--to compensate them not as directors but for acting in their capacity of officers and administrative staff of ORG. Minutes of same date - authorized BM-1- V.P. Director Acquisitions & Development to open and act on behalf of ORG on its checking and savings accounts.

The minutes of April 20, 20XX authorized BM-1- Director of Real Estate Operations and BM-2, Director, to have signatory authority and act as ORG's agent with full powers of the Board,

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including but not limited to: negotiating and executing any documents necessary in connection with the operations/opening of a credit line, bank account or credit card for ORG.

The minutes of June 1, 20XX authorized payment of Developer's Fee to persons in the day to day operations of ORG: BM-1, BM-2 and Secretary. The payments were for their acting in their capacities as officers and administrative staff of ORG, not as directors.

Said fee was to be paid from each property sold and was to be a sum of up to ten percent (10%) of the sales' price. The fee was mandated by HUD. Said fee was to be paid regardless of any real estate commissions to any person whether representing ORG in the sales' transactions. The resolution was retroactive and applied to all services, labor, etc. from Jan. 1, 20XX forward.³

On 1/20/20XX BM-2 resigned as ORG's President and Director.
No minutes were provided past that date.

On 6/24/02 BM-1, CEO, signed the Statement of officers with the State of XYZ that listed the following as ORG's officers: BM-1-CEO, BM-6-Secretary, and BM-3- CFO.

On 11/5/20XX Secretary-Manager signed a statement of officers that was filed with the State of XYZ that listed the following as ORG's officers: BM-1-CEO, BM-3 Secretary and CFO.

ORG Activities

On June 3, 19XX, US Dept. of Housing and Urban Development sent a letter to Secretary, CO-1 Executive Director, accepting Urban Housing & Development as participant in FHA/HUD's 203b Single Family Property Disposition sales. As an approved non-profit agency the organization could purchase HUD acquired properties at a 10 percent discount (or 30% if the house is located in an area classified as a revitalization area).

HUD notified the organization on Dec. 14, 19XX that it will need to provide information to HUD for each property purchased during the prior fiscal year. Such information includes: property address, date purchased, acquisition cost, financing acquired, rehabilitation cost, date and price of resale, purchaser's name and median income certification, and property currently rented or leased (date and rent amounts).

On 7/3/01 HUD⁴ notified the organization via certified mail (addressed to BM-1- President, Acquisitions and Development) of its final decision after considering the information that was discussed during the meeting of Jan, 4, 20XX and ORG's subsequent letters dated 4/3/20XX and 5/17/20XX. HUD affirmed the earlier decision to remove ORG from participation in HUD program based on the following reasons:

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- ORG failed to provide documentation, including to provide results of corporate audit mentioned in ORG's 4/3/20XX letter to HUD; under HUD'S Mortgage Letter 00-8 attachment 4, - failure to respond to HUD's inquires is a reason for removal.
- BM-1 is a real estate agent and a former ORG consultant. ORG's letter of 5/17/XX asserted that BM-1 is not a board member, but is an employee and a principal staff member. Both BM-1 and Secretary have directed the ORG's affordable housing program and derived personal gains including:
 - (a) ORG's property at Address property is leased to BM-1- she resides there.
 - (b) Secretary uses the same property
 - (c) BM-1's employer -CO-3, received commissions on the following properties

<u>PURCHASE:</u>	<u>RESALE:</u>
Address- \$	Address, \$
Address \$	Address, \$
	Address, \$

Under HUD's Mortgage Letter 96-52, a non profit must demonstrate that it is acting under no undue influence or direction of outside parties seeking to derive a profit from the proposed project such as real estate broker, contractor or consultant; additional restrictions are imposed on deep discounted properties, including avoiding conflict of interest – with individuals that provide any services associated with the projects.

- HUD determined that ORG failed to provide low income affordable housing in pursuit of its stated purpose as shown on its articles; HUD's information shows that buyers of three properties were high income earners:
 - Address- earned 192% of 20XX County median income
 - Address –earned 240% of 20XX County median income
 - Address –earned 132.85% of 20XX County median income⁵
 - The property at Address was not an affordable program re-sale (it is a 4-plex)⁶

IRS Examination of ORG Charitable Activities:

ORG has not required nor obtained income information and verification from the buyers of its properties; this was done by the lenders. Therefore, ORG could not provide such documentation to IRS showing it sold properties to persons who are members of the intended charitable class, namely, low income and distressed persons.⁷

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In reply to IRS questions, ORG provided a statement that the income of the buyers for of the property at Address City was \$ for a family of four. The information conflicts with HUD's letter. HUD's letter documented that the buyers earned \$ – equal to 192.75% of the 20XX County median income of \$ for a family of three.

Similar discrepancy happened with the buyers' income documentation for the property at Address, City. ORG statement was that the buyers were a family of 5 persons and they had income of \$- This information conflicts with HUD's documentation that the buyers earned \$ - 132.85% of 20XX median income- for a family of four in County of \$⁸

Property Transaction at Address, City XYZ

The property was purchased at or around May 19, 20XX⁹ by CO-1 and BM-5 for \$.¹⁰ According to the Deed of Trust that was obtained from a third party, the purchase loan was \$ and it was signed by two co-borrowers: BM-5 and CO-1 (by BM-1- Real Estate Operations Designee)¹¹. No document was provided to show how title to property was held.

On or around April 18, 20XX and BM-5 executed a Corporation Grant Deed (that was signed by both BM-1 for the organization and BM-5 for herself) and granted ownership of the property to CO-4, a XYZ corporation owned by BM-1.¹² No sale's contract was signed to document what the nature of the transaction was and nothing was noted on ORG's minutes.¹³ On Feb. 16, 20XX, CO-4 sold the property to CO-5. for \$.¹⁴ The above documentation conflicts with the letter and affidavit dated 5/11/20XX that ORG sent to HUD stating that the property was not sold¹⁵.

During the April 11, 20XX meeting BM-1 told IRS auditor that the property was purchased by two individuals: BM-5 and BM-1, but they put the organization's name on the deed. BM-1 said that BM-5 sold the building to CO-4. The sale was for \$. No sale's agreement was provided in support of this statement.

Year 20XX Sale of Property at Address:

On 5/14/02 ORG sold a property comprised of vacant land located at: Address, City, XYZ for \$. The net proceeds due seller of \$ was paid by checks that the closing agent, CO-8 issued as follows:

\$- payable to: BM-1

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Total= \$- payable to: XYZ.
\$

The checks were deposited to ORG bank account. No documentation was provided to explain why \$ of the sale's proceeds was to be paid to BM-1¹⁶.

Financial Activity of ORG:

The main account that ORG used for its operations in 20XX was CO-6 account. An additional account that was used in 20XX was an CO-7 account that had a visa credit card linked to it. BM-1 and BM-2 were the signors on the account. The records that ORG provided to IRS auditor included bank statements for CO-6 through Oct. 20XX, statements for the CO-7 for the period 1/1/XX through 4/25/XX (a few statements were missing) a general ledger and a check register.

IRS auditor requested ORG repeatedly to provide cancelled checks and documentation as to the business purposes its disbursements served. ORG failed to provide most of these records.

ORG records such as its general ledger did not include any comments describing the nature of the deposits made to its bank account. Copies of the deposited items were obtained during the examination from CO-6. A few deposits were linked to BM-1: the 7/24/20XX deposit of \$ by her personal check and the cash deposits of 2/14/XX and 2/19/XX of -\$ and \$ respectively. There were also other cash deposits that were not documented as to their source. BM-1 described the cash deposits to ORG account as her "loans". IRS auditor requested records documenting what the source of the cash for the loans was by providing bank statements etc. showing corresponding withdrawals from BM-1's bank account.¹⁷

TABLE A: The financial activity and deposits in CO-6 Account is described below:

CO-6 of XYZ- Business Checking ACCOUNT				
<u>DATE</u>	<u>Beg. Balance</u>	<u>Additions</u>	<u>Subtraction</u>	<u>Ending Balance</u>
1/1/XX-1/31/XX				
2/1/XX-2/28/XX				
3/1/XX -3/ 9XX				
3/30/XX-4/30XX				
5/1/XX -5/31XX				
6/1/XX-6/28/XX				
6/29/XX -7/31/XX				
8/1/XX -8/30/XX				
8/31/XX-9/30/XX				
10/1/XX-10/31/XX				

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Total:	_____
Less: transfers .	
Net deposits:	_____

TABLE B: The financial activity in CO-7:

Bank Activity CO-7 ACCOUNT									
DATE	<u>Beginning</u> Balance	<u>Additions</u>	<u>Interest</u>	<u>Subtraction</u>	<u>XX</u> Charges	<u>Other</u>	<u>Ending</u> Balance	Notes:	
1/1/XX-1/25/XX									
1/26/XX-2/22/XX									
2/23/XX-3/28/XX									
3/29/XX-4/26/XX									
4/17/XX-5/31/XX									
6/1/XX-6/28XX									
6/29/XX-7/26/XX									
7/27/XX-8/30/XX									
8/31/XX-9/27/XX									
9/28/XXthrough 12/31/XX	not provided to IRS								
1/1/XX-3/28/XX									
3/29/XX-4/25/XX									
TOTAL:									

ORG disbursements:

In 20XX the largest amounts of disbursements were paid to Secretary and BM-1.

Additional disbursements included: Payments for CO-9 (electricity and gas), mortgage and property insurance for the property located at Address, City, XYZ.

Mortgage payments to CO-10 (mortgagor on Address);

Payments for vehicles: insurance premium and monthly lease payments for two leased vehicles.

No documentation was provided as to the disposition of the vehicles.

ORG received a "Notice of our Plan to Sell Property" from CO-2 Company dated 2/13/20XX.¹⁸

No vehicle usage log was provided to show that the vehicles were used for the organization's charitable activities. Further evidence that the vehicles were used by the BM-1&6 for personal use is the fact that BM-1 deposited her personal check on 7/8/XX to ORG account, where she paid \$ for vehicle use.

An analysis of the disbursements made from ORG account shows disbursements grouped by categories as described in Table C below:

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¹⁸ The vehicles were leased jointly by

and BM-4.

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TABLE C: Disbursements Grouped by Categories:

<u>List of Payments --From CO-6</u> BM-1-various Vehicle Lease/insurance BM-6-various Secretary-Variou BM-3-- Loan (to purchase a property) ¹⁹ <u>Total:</u> Table D <u>Total:</u> Less: documented loan: <u>Less: car use reimbursement</u> Total Funds removed for personal use _____ Tax, Insurance. % of personal expenses out of total income =67%	Notes
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TABLE D: Analysis of Linked to CO-7 Account

<u>Tickets/air</u>	<u>Hotel/rental car</u>	<u>Cash</u>	<u>Misc.</u>	<u>Total</u>

Year 20XX

Property Lease/Purchase and Subsequent Sale: Address, City

ORG conducted a Lease Option program where it leased one property to a low income buyer with an option to buy. On 8/30/19XX CO-1 (by BM-1 and Secretary) purchased a single family residence located at Address City for \$.²⁰ The purchase loan on the property was \$. On 2/7/20XX CO-1 and BM-1 entered into a residential lease transaction. Under the lease the tenant- BM-1 was to pay \$/mo in advance each 7th calendar day of the month. The \$ monthly rent included CO-9, water and maintenance. The premises were to be occupied by BM-1, BM-6 and BM-7. The tenant received an option to purchase the property. BM-1 did not exercise the option to purchase the property from ORG.²¹

In 20XX the property was subject to a CO-10 loan #. In 20XX BM-1 lived at the property but failed to pay the \$ of monthly rental fee to ORG. She told IRS auditor that she made the mortgage payments directly but has not provided records to this effect. ORG made \$ of mortgage payments to this lender in 20XX.

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On 5/31/03²² BM-1 accepted an offer from PER-1 to purchase the property for \$. The signor for the seller was BM-1 (signing for herself- no fiduciary or title was listed). The transaction did not require that the purchaser pay any cash until close of escrow- and no escrow was executed for the transaction.

The buyer was to pay for the property as follows:

\$- by personal note which was to be uncashed until close of escrow.

\$ by assuming the first FHA loan. The seller was to allow buyer to assume the FHA loan

\$-was a credit to buyer from the seller.

\$- balance; to be deposited with Escrow Holder in sufficient time to close escrow. The document did not specify who the Escrow Holder was. No escrow document was provided

Total: \$.

ORG had declined to provide documentation to IRS to document key facts such as: 23

The Existence of lease between the "purchaser" and BM-1 (she continued to live there past the sale and Secretary still receives mail there), if any appraisal was undertaken prior to the purported sale, how the buyer paid for the purported purchase and if ORG received these payments.

On 7/8/XX, BM-1 signed a Grant Deed where she, as the President of CO-1 granted the property at Address, City, to PER-1.

On 6/30/20XX CO-11 issued a Preliminary Report that showed that the title to the property as of that date was vested in PER-1. The report shows that there is a deed of trust to secure indebtedness as follows;

Amount: \$
Date: 12/10/19XX
Trustor:
Loan #:

The report shows that a notice of default under the terms of said deed of trust was recorded on 1/7/20XX as document No. 20XX- , official records.

Also, a lien for unsecured property taxes was filed by the tax collector of the county of County against CO-1 for \$and \$.

On 11/24/XX²⁴ PER-1 borrowed \$from CO-10 and took cash out of \$. An estimated valuation for the property was obtained; it was valued approximately at \$at that time.²⁵ No records were

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produced to show that ORG received cash from PER-1 or that ORG board approved the purported sale.

Organization is a non-filer

ORG has not filed Form 990 for year ending Dec. 31, 20XX and IRS' letter asking why no return has been filed in 20XX12 was returned unsigned; someone stated in writing that the organization became inactive effective Jan. 20XX. ORG has not filed Forms 990 past the year 20XX. The organization had significant financial transactions during the years 20XX through 20XX. In 20XX ORG sold properties for: \$²⁶ and in 20XX ORG had gross income of approximately \$.

Unresolved IRS lien and UCC Filing:

The organization obtained a second EIN: - and filed Form 990 for year 20XX. IRS' assessed tax on the organization since there was no record that the entity represented by that EIN was exempt and placed a lien of: \$on 9/12/20XX. During the examination ORG has not provided any documentation of attempts to contact IRS to resolve the outstanding lien.

BM-1 recorded a UCC claim on 7/7/20XX against ORG. In support of her claim she provided IRS auditor with various checks she used for making loans to ORG in 19XX and 20XX. These claims conflict with the information on ORG Forms 990 that were filed for years 19XX and 20XX with the IRS; Forms 990 did not report any loans to officers, directors or to BM-1 or Secretary. ORG minutes do not support these loans either. During the years 20XX-20XX IRS received records of financial activities that were conducted under ORG EIN(s) which are described in the table below:

SUMMARY OF FILING ACTIVITY with IRS Primary EIN

<u>Year</u>	<u>Documents</u>	<u>Amounts</u>	<u>Notes</u>
20XX	1098	\$	
20XX	1098	\$	
20XX	1098 CO-1	\$	
	1098 BM-5/ CO-1	\$	
	1099-S	\$	
	1099-S 5250	\$	
	1099-S 5250	\$	
	1099-S	\$	

LAW

continued footnote

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Issue #1: 1. Should the Section 501(c)(3) exemption ruling issued to ORG (hereinafter the “ORG”) be revoked because its operations served private interests of its founders and insiders and conferred impermissible inurement on its insiders?

a. Requirement for Exemption under IRC 501(c)(3)

Section 501(c)(3) of the Internal Revenue Code provides for the exemption from federal income tax of organizations that are organized and operated exclusively for charitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that an organization must be both organized and operated exclusively for one or more of the purposes specified in section 501(c)(3) of the Code in order to be exempt as an organization described in such section.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as “operated exclusively” for one or more exempt purposes only if it is engaged primarily in activities that 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.

Section 1.501(c)(3)-1(c)(2) of the regulations 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.

Section 1.501(c)(3)-1(d)(ii) of the regulations states that an organization is not organized or operated for one or more exempt purposes unless it serves a public rather than a private interest. Accordingly, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator, shareholders, or persons controlled, directly or indirectly, by such private interests.

b. Cases: Existence of a Substantial Single Non-Exempt Purpose, Can Destroy Exemption under 501(c)(3)

Better Business Bureau v. United States, 316 U.S. 279 (1945), holds that the existence of a single non-exempt purpose, if substantial in nature, will destroy the exemption under section 501(c)(3). An organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such purposes.

c. Cases Where Exemption under 501(c)(3) Was Revoked Due to Inurement or Private Benefit

In P.L.L. Scholarship Fund v. Commissioner, 82 T.C. 196 (1984) [CCH Dec. 40,960], the Tax Court concluded that an organization that raised funds for charity by conducting bingo games in a bar owned

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by the organization's directors had the substantial private purpose of making food and beverage sales for the benefit of the bar's owner. On this basis, the Court concluded that the organization could not qualify for exemption under section 501(c)(3).

In American Campaign Academy v. Commissioner [CCH Dec. 45,704], 92 T.C. 1053 (1989), the Tax Court was called on to decide whether benefit to third parties, who were not members of the organization, would prevent the organization from being recognized as an exempt organization within the meaning of section 501(c)(3) of the Code. The Court concluded that the organization could not confer benefits on disinterested persons and still serve public purposes within the meaning of section 1.501(c)(3)-1(d)(1)(ii) of the regulations.

The petitioner was organized for the purpose of providing continuing medical education to physicians. To this end, it took physicians on three-week tours throughout the world. The petitioner shared offices with a for-profit travel agency which was controlled by the petitioner's principal officer. It made all its travel arrangements through the agency. The Court found that a substantial purpose of the petitioner was benefiting the for-profit travel agency. It concluded "when a for-profit organization benefits substantially from the manner in which the activities of a related organization are carried on, the latter organization is not operated exclusively for exempt purposes within the meaning of (section) 501(c)(3), even if it furthers other exempt purposes."

In Wendy L. Parker Rehabilitation Foundation, Inc. v. Commissioner, TC Memo. 1986-348, 52 TCM 51, Filed August 4, 1986 A not-for-profit corporation organized for the purpose of providing care and treatment for coma victims in stages of recovery was denied an exemption from taxation. The adverse ruling of the IRS was upheld by the Tax Court because a child of the founder and chief operating officer of the foundation was a substantial beneficiary of the services provided by the organization. This constituted inurement for the benefit of a private individual which is prohibited under the qualifications for exemption.

In Share Network Foundation v. Commissioner, 78 TCM 6, Filed July 2, 1999 A foundation organized by a promoter of tax-exempt entities failed to establish that it was operated exclusively for exempt purposes and, accordingly, was denied tax-exempt status. The organization provided only vague answers to IRS requests for information, leading to the inference that the facts, if disclosed, would show that the organization failed to meet the requirements for exemption.

TAXPAYER'S POSITION:

Is yet to be received.

GOVERNMENT POSITION:

The government contends that ORG ("ORG") failed to meet the "operational test" under IRC 501(c)(3) and the Regulations Section 1.501(c)(3)-1(d)(ii). It did not operate exclusively for charitable purposes because it sold properties to persons who were high income and were not members of a charitable class and it did not limit its operations to those benefiting the intended charitable class, namely, poor people.

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ORG thus, was engaged in substantial non-charitable activities, namely, selling real estate to people regardless of their income level. As provided Better Business Bureau, the existence of non-exempt purpose if substantial in nature, destroys exemption under 501(c)(3). ORG also operated in violation of the requirements of IRC 501(c)(3) because it served substantial non-exempt private interests when it provided substantial benefits to private persons, including Secretary and BM-1, BM-6 and BM-3. Since these persons were in control of the ORG, a 501(c)(3) organization, this caused the inurement of the ORG net assets to the ORG insiders. The housing and financial operations of ORG were used to benefit the BM's family. As provided in PER-2, once the organization's insiders are the recipients of the organization's services and resources, the organization operates in violation of Section 501(c)(3), such is the case here, where the expenses to improve the insiders' welfare amounted to approximately 67% of the total income the ORG received during the year. Accordingly, the organization's exemption should be revoked effective January 1st, 20XX.

Issue #2. Should the Section 501(c)(3) exemption ruling issued to ORG be revoked because it failed to keep records to show that its operations serve the intended charitable beneficiaries and because it also failed to observe the annual filing of information returns Forms 990 as required from organizations exempt under Internal Revenue Code (IRC) 501(c)(3)?

LAW:

Section 6001 of the Code provides that every person liable for any tax imposed by the Code, or for the collection thereof, shall keep adequate records as the Secretary of the Treasury or his delegate may from time to time prescribe.

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

Section 1.6001-1(a) of the regulations in conjunction with section 1.6001-1(c) provides that every organization exempt from tax under section 501(a) of the Code and subject to the tax imposed by section 511 on its unrelated business income must keep such permanent books or accounts or records, including inventories, as are sufficient to establish the amount of gross income, deduction, credits, or other matters required to be shown by such person in any return of such tax. Such organization shall also keep such books and records as are required to substantiate the information required by section 6033.

Section 1.6001-1(e) of the regulations states that the books or records required by this section shall be kept at all times available for inspection by authorized internal revenue officers or employees, and shall be retained as long as the contents thereof may be material in the administration of any internal revenue law.

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Name of Taxpayer ORG		Year/Period Ended 20XX12

Section 1.6033-1(h)(2) of the regulations provides that every organization which has established its right to exemption from tax, whether or not it is required to file an annual return of information, shall submit such additional information as may be required by the district director for the purpose of enabling him to inquire further into its exempt status and to administer the provisions of subchapter F (section 501 and the following), chapter 1 of the Code and section 6033.

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

TAXPAYER POSITION:

Is yet to be received.

GOVERNMENT POSITION:

In accordance with said provisions of the Code and regulations under sections 6001 and 6033, organizations recognized as exempt from federal income tax must meet certain reporting requirements. These requirements relate to the filing of a complete and accurate annual information (and other required federal tax forms) and the retention of records sufficient to determine whether such entity is operated for the purposes for which it was granted tax-exempt status and to determine its liability for any unrelated business income tax.

Conclusion: It is the IRS's position that the organization failed to meet the reporting requirements under sections 6001 and 6033 to be recognized as exempt from federal income tax under 501(c)(3) of the Internal Revenue Code because it did not comply with the filing of Forms 990 and it failed to retain records to show that its main activity, namely the resale of homes was charitable and served charitable class of beneficiaries. Accordingly, the organization's exempt status is revoked effective January 1, 20XX.

Form 1120 returns should be filed for the tax periods ending December 31, 20XX.



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY

Internal Revenue Service
TE/GE Division
55 S. Market Street, HQ 7600
San Jose, CA 95113-2324

October 26, 2006

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