



DEPARTMENT OF THE TREASURY

Internal Revenue Service
TE/GE EO Examinations
1100 Commerce Street
Dallas, TX 75424

TAX EXEMPT AND GOVERNMENT ENTITIES DIVISION

August 15, 2008

Release Number: 200850041

Release Date: 12/12/08

LEGEND

ORG = Organization name XX = date Address = address

ORG
ADDRESS

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

UIL: 501.03-01

LAST DATE FOR FILING A PETITION
WITH THE TAX COURT: November 13, 20XX

CERTIFIED MAIL – RETURN RECEIPT

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 June 19, 20XX.

Our adverse determination was made for the following reasons:

1. ORG is not operated for an exclusive exempt purpose, as is required by IRC section 501(c)(3) and Treas. Reg. section 1.501(c)(3)-1(d).
2. A substantial part of the activities of ORG furthers private interests (monies returned to trustee) rather than public interests, which is prohibited by Treas. Reg. section 1.501(c)(3)-1(d)(1)(ii). The foundation failed to make financial distributions or provide any activity as a supporting organization to a specified organization.
3. The organization did not operate exclusively for exempt purposes because it was organized and operated for the benefit of private interests, rather than public interests and its net earnings and assets inured to the benefit of its creators, trustees and directors., which is prohibited by IRC section 501(c)(3).

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:

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 No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 12/31/20XX, 12/31/20XX, 12/31/20XX

LEGEND

ORG = Organization name XX = Date XYZ = State Donor Family = donor family
 Donor = Donor Trustee = trustee BM-1 & BM-2 = 1st & 2nd board members
 CO-1, CO-2, CO-3 & CO-4 = 1st, 2nd, 3rd & 4th Companies

PRIMARY ISSUE: Whether the IRC § 501(c)(3) tax exempt status of ORG should be revoked, effective January 1, 20XX, because it is not operated exclusively for tax exempt purposes?

FACTS:

DECLARATION OF TRUST

ORG (the "Organization") was created with a Declaration of Trust (Declaration) by Trustee and Donor (hereinafter sometimes collectively referred to as "Donor") and Trustee (hereinafter sometimes referred to as "Trustee.") on February 1, 19XX. Pursuant to the Declaration, the Organization was created for the purpose of establishing an organization which is described in Internal Revenue Code (IRC) section 501(c)(3) and IRC section 509(a)(3) .

The Declaration provides, in part:

The Trust is organized, and at all times thereafter will be operated exclusively to support or benefit, as defined by Treasury Regulation 1.509(a)-4(b)(1), one or more publicly supported organizations, including the CO-1 as the primary charity. . . No part of the net earnings of this Trust shall inure to the benefit of any individual, and no part of the activities of this Trust shall consist of carrying on propaganda, or otherwise attempting to influence legislation or participating in or intervening in (including the publication or distribution of statements) any political campaign on behalf of any candidate for public office.

The Trust shall be irrevocable. Donor hereby expressly waives the right and the power to alter, amend, revoke, or terminate the Trust or any of the terms of this Declaration. Donor hereby renounces any power to determine or control or control, by alteration, amendment, revocation, termination or otherwise, and Donor renounces any interest in either vested or contingent, including any reversionary interest or possibility of reverter, in the income or principal of the trust estate.

Each year the Trustee shall distribute thirty-five percent (35%) of the net income the Trust to the CO-1. For purposes of this Agreement, net income shall be determined pursuant to the laws of the State of XYZ. It is intended that the distributions to the CO-1 will help the CO-1 perform its functions and carry out its purposes. In order to insure that this happens, the Board shall meet with the governing body of the CO-1, or a representative thereof, to determine the use of such distributions.

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In addition to this distribution, each year the Trustee shall distribute a total of 50% of the net income of this Trust to one or more organizations listed on Schedule A, which by this reference is made a part hereof, or to the CO-1 as is directed by the Board in writing signed by at least (3) members of the Board.

In the event the Trustee determines, in Trustee's sole and complete discretion, that the Trust Fund, is too small to economically administer, then in such event the Trustee shall distribute the Trust Fund in its entirety outright and free of trust to such organizations as described in IRC 170(c)(2) as the Trustee, in Trustee's total and complete discretion, shall determine.

Upon winding up and dissolution of this Trust, after paying or adequately providing for the debts and obligations of the Trust, the remaining assets shall be distributed to a non-profit fund, foundation, or corporation which is organized and operated exclusively for charitable, educational, religious, and/or scientific purposes and which has established its tax exempt status under section 501(c)(3) of the Code. In the event that the Trust does not obtain tax exempt status under sections 501(c) (3) and 509(a)(3) of the Code, the assets of the Trust shall go to the Donor Family, as defined herein, as a contingent remainder.

The Board shall be that body that has the authority, power, and discretion as described herein. The Board shall consist of (5) members. The members of the Board shall be determined as follows: One Board member shall be appointed by the CO-1 or its designated agent; Two Board members shall be from the class consisting of Trustee and Donor and each of their descendants (the "Donor Family"); The other members of the Board shall be appointed by a majority vote of the board. The initial remaining Board members shall be BM-1 and BM-2.

In 19XX, the Donors donated \$ in cash and \$ in noncash items (notes receivable to companies and stock). The loans and investments were reported on the 19XX Form 990. The companies later went bankrupt and the loans and investments were subsequently written off.

There are approximately 80 organizations listed on Schedule A.

TAX EXEMPT STATUS

Based on its representations during the application process, by letter dated August 20XX, the Organization was recognized by the Service as exempt from Federal income tax under section 501(a) as an organization described in section 501(c)(3) and classified as an organization that is not a private foundation because it is described in section 509(a)(3).

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BOARD OF DIRECTORS

In 20XX, 20XX and 20XX, the members of the Board of Directors were and Donor, and BM-2 and . From inception, no board members of the Organization had any connection with the primary supported organization and no members were chosen by the primary supported organization. Neither the primary supported organization or any other public charity had any voice in the Organization's operations.

BOARD OF DIRECTORS MEETING MINUTES

From inception, the Organization has never conducted any board of directors meetings.

MEETINGS WITH PRIMARY AND SECONDARY CHARITIES

The Organization did not meet with any charity during calendar years 20XX, 20XX and 20XX.

ORG FORMS 990

This chart shows sources of revenue, expenses, assets, liabilities and net assets.

	<u>TY 20XX</u>	<u>TY 20XX</u>	<u>TY 20XX</u>
<u>Revenue</u>			
Contributions			
Interest			
Dividends			
Gain(Loss) on Sale of Assets			
Total Revenue			
<u>Expenses</u>			
Grants			
Accounting Fees			
Investment fees			
Total Expenses			
<u>Assets, Liabilities and Net Assets</u>			
Cash			
Other notes & loans receivable			
Investments – Other			
Other Assets			
Total Assets			
Total liabilities			
Net assets/fund balance			

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GRANTS AND CONTRIBUTIONS

The chart shows grants and contributions to charitable entities:

TY 20XX TY 20XX TY 20XX

LOANS AND INVESTMENTS

The 20XX Form 990 of the Organization showed a \$ loss on securities and a \$ loss on notes and accounts receivable. At the end of 20XX both assets were deemed worthless and written off due to the dot.com collapse, terrorist attacks and stock market decline. The Organization failed to maintain adequate books and records, could provide only partial records to substantiate the losses, questioned amounts reported on Forms 990 as reported by their accounting firm and were unable secure requisite records from the accounting firm. The Organization stated substantially all losses were due to bad investments in and loans to the CO-2, CO-3 and CO-4.

LAW:

IRC § 501(c)(3) exempts from Federal income tax: corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

Regulation section 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as “operated exclusively” for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Regulation section 1.501(c)(3)-1(c)(2) provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. The words “private shareholder or individual” refer to persons having a personal and private interest in the activities of the organization.

Regulation section 1.501(c)(3)-1(d)(1)(ii) provides an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private

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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.

Section 1.6001-1(c) of the Income Tax Regulations provides, "Exempt organizations. In addition to such permanent books and records as are required by paragraph (a) of this section with respect to the tax imposed by section 511 on unrelated business income of certain exempt organizations, every organization exempt from tax under section 501(a) shall keep such permanent books of account or records, including inventories, as are sufficient to show specifically the items of gross income, receipts and disbursements. Such organizations shall also keep such books and records as are required to substantiate the information required by section 6033. See section 6033 and 1.6033-1."

Section 1.6001-1(e) of the Income Tax Regulations provides, "Retention of records. 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 so long as the contents thereof may become material in the administration of any internal revenue law."

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 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 Walter Mack Podolece, Petitioner v. Commissioner of Internal Revenue, Respondent, T.C. Memo 1922-227; 1992 Tax Ct. Memo Lexis 268; T.C.M.(CCH) 2785, the court found: ". . . Where a taxpayer fails to keep the required books and records, respondent is authorized under section 446 to reconstruct income in accordance with a method which clearly reflects the full amount of income received. Petzoldt v. Commissioner, 92 T.C. 661, 686-687 (1989)."

In Petzoldt v. Commissioner, 92 T.C. 661; 1989 U.S. Tax Ct. LEXIS 42, 92 T.C. No. 37, the court found: ". . ."Section 6001 requires all taxpayers to maintain sufficient records to determine their correct tax liabilities. Where a taxpayer fails to keep the required books and records, or if the records he or she maintains do not clearly reflect income, then respondent is authorized by

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section 446 to reconstruct income in accordance with a method which clearly reflects the full amount of income received. Meneuzzo v. Commissioner, 43 T.C. 824, 831 (1965). See also Miller v. Commissioner, 237 F.2d 830, 838 (5th Cir. 1956),. . .”

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

GOVERNMENT’S POSITION:

The IRC § 501(c)(3) tax exempt status of ORG (the “Organization”) should be revoked because it is not operated exclusively for tax exempt charitable purposes.

The Organization conducted no charitable activities in 20XX, 20XX and 20XX. No grants were made to charities, no board meetings were held, and no contact was made with any charities.

As substantial contributors, Trustee and Donor are disqualified persons and insiders. There is no indication that the investments and terms of the notes were considered by the entire board, that alternative investments for the Organization were ever considered, that the investments and notes were reviewed by anyone acting in the interests of charity and there is no evidence that the Organization made any attempts at collection.

There is no evidence that the board attempted to ensure that the Organization received the payments due on the loan. It does not appear that any attempt was made to ensure the Organization’s assets or income were protected.

The lack of charitable activities, the continued failure to protect the value of the investments, the lack of board of directors’ meetings to discuss alternative investments, and the lack of oversight of any investment, all establish that the Organization is operated for non-exempt purposes.

The “loans” were not conducted in a business-like fashion, they were not secured, there was no evidence at attempt to recover the losses.

The Organization fails to serve a public, rather than a private interest, and therefore is not operated exclusively for charitable purposes. Accordingly, ORG is operated for a substantial non-exempt purpose and fails to qualify for exemption from Federal income tax as an organization described under Section 501(c)(3) . See Revenue Ruling 67-5.

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CONCLUSION:

Accordingly, the Organization's status as an organization described under section 501(c)(3) should be revoked, effective January 1, 20XX, because it did not operate exclusively for exempt purposes.

Form 1041 U.S. Income Tax Return for Estates and Trusts should be filed for tax years ending December 31, 20XX through December 31, 20XX. Subsequent returns are due no later than the 15th day of the 4th month following the close of the trust's accounting period.

Returns for years ended December 31, 20XX through December 31, 20XX should be sent to the following mailing address:

TAXPAYER'S POSITION:

The Organization agrees to revocation of their IRC 501(c)(3) tax exempt status. Trustee stated that no personal gain or tax benefit was ever derived by any member of the Donor Family from the Organization, that had he known the complex rules and regulations required of a IRC 509(a)(3) supporting organization he never would have established the Organization and that he never received any guidance from the promoter who recommended the Organization be formed.

ALTERNATIVE ISSUE: In the alternative, whether ORG should be reclassified as a private foundation.

FACTS:

See prior discussion.

LAW:

Income Tax Regulations section 1.509(a)-4(c) regarding the organizational test a 509(a)(3) organization must meet provides:

(1) *In general.* —An organization is organized exclusively for one or more of the purposes specified in section 509(a)(3)(A) only if its articles of organization (as defined in §1.501(c)(3)-1(b)(2)):

(i) Limit the purposes of such organization to one or more of the purposes set forth in section 509(a)(3)(A);

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- (ii) Do not expressly empower the organization to engage in activities which are not in furtherance of the purposes referred to in subdivision (i) of this subparagraph;
- (iii) State the specified publicly supported organizations on whose behalf such organization is to be operated (within the meaning of paragraph (d) of this section); and
- (iv) Do not expressly empower the organization to operate to support or benefit any organization other than the specified publicly supported organizations referred to in subdivision (iii) of this subparagraph.

Income Tax Regulations section 1.509(a)-4(e) regarding the operational test a 509(a)(3) organization must meet provides:

(1) *Permissible beneficiaries.* —A supporting organization will be regarded as “operated exclusively” to support one or more specified publicly supported organizations (hereinafter referred to as the “operational test”) only if it engages solely in activities which support or benefit the specified publicly supported organizations. Such activities may include making payments to or for the use of, or providing services or facilities for, individual members of the charitable class benefited by the specified publicly supported organization. A supporting organization may also, for example, make a payment indirectly through another unrelated organization to a member of a charitable class benefited by a specified publicly supported organization, but only if such a payment constitutes a grant to an individual rather than a grant to an organization. In determining whether a grant is indirectly to an individual rather than to an organization the same standard shall be applied as in §53.4945-4(a)(4) of this chapter. Similarly, an organization will be regarded as “operated exclusively” to support or benefit one or more specified publicly supported organizations even if it supports or benefits an organization, other than a private foundation, which is described in section 501(c)(3) and is operated, supervised, or controlled directly by or in connection with such publicly supported organizations, or which is described in section 511(a)(2)(B). However, an organization will not be regarded as operated exclusively if any part of its activities is in furtherance of a purpose other than supporting or benefiting one or more specified publicly supported organizations.

(2) *Permissible activities.* —A supporting organization is not required to pay over its income to the publicly supported organizations in order to meet the operational test. It may satisfy the test by using its income to carry on an independent activity or program which supports or benefits the specified publicly supported organizations. All such support must, however, be limited to permissible beneficiaries in accordance with subparagraph (1) of this paragraph. The supporting organization may also engage in fund raising activities, such as solicitations, fund raising dinners, and unrelated trade or business to raise funds for the publicly supported organizations, or for the permissible beneficiaries.

Income Tax Regulations section 1.509(a)-4(f) regarding the nature of relationships required for section 509(a)(3) organizations provides:

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(1) *In general.* —Section 509(a)(3)(B) describes the nature of the relationship required between a section 501(c)(3) organization and one or more publicly supported organizations in order for such section 501(c)(3) organization to qualify under the provisions of section 509(a)(3). To meet the requirements of section 509(a)(3), an organization must be operated, supervised, or controlled by or in connection with one or more publicly supported organizations. If an organization does not stand in one of such relationships (as provided in this paragraph) to one or more publicly supported organizations, it is not an organization described in section 509(a)(3).

(2) *Types of relationships.* —Section 509(a)(3)(B) sets forth three different types of relationships, one of which must be met in order to meet the requirements of subparagraph (1) of this paragraph. Thus, a supporting organization may be:

- (i) Operated, supervised, or controlled by,
- (ii) Supervised or controlled in connection with, or
- (iii) Operated in connection with, one or more publicly supported organizations.

(3) *Requirements of relationships.* —Although more than one type of relationship may exist in any one case, any relationship described in section 509(a)(3)(B) must insure that:

- (i) The supporting organization will be responsive to the needs or demands of one or more publicly supported organizations; and
- (ii) The supporting organization will constitute an integral part of, or maintain a significant involvement in, the operations of one or more publicly supported organizations.

(4) *General description of relationships.* —In the case of supporting organizations which are “operated, supervised, or controlled by” one or more publicly supported organizations, the distinguishing feature of this type of relationship is the presence of a substantial degree of direction by the publicly supported organizations over the conduct of the supporting organization, as described in paragraph (g) of this section. In the case of supporting organizations which are “supervised or controlled in connection with” one or more publicly supported organizations, the distinguishing feature is the presence of common supervision or control among the governing bodies of all organizations involved, such as the presence of common directors, as described in paragraph (h) of this section. In the case of a supporting organization which is “operated in connection with” one or more publicly supported organizations, the distinguishing feature is that the supporting organization is responsive to, and significantly involved in the operations of, the publicly supported organization, as described in paragraph (i) of this section.

Income Tax Regulations section 1.509(a)-4(g) provides guidance on the meaning of “operated, supervised, or controlled by” as follows:

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(1)

(i) Each of the items “operated by”, “supervised by”, and “controlled by”, as used in section 509(a)(3)(B), presupposes a substantial degree of direction over the policies, programs, and activities of a supporting organization by one or more publicly supported organizations. The relationship required under any one of these terms is comparable to that of a parent and subsidiary, where the subsidiary is under the direction of, and accountable or responsible to, the parent organization. This relationship is established by the fact that a majority of the officers, directors, or trustees of the supporting organization are appointed or elected by the governing body, members of the governing body, officers acting in their official capacity, or the membership of one or more publicly supported organizations.

(ii) A supporting organization may be “operated, supervised or controlled by” one or more publicly supported organizations within the meaning of section 509(a)(3)(B) even though its governing body is not comprised of representatives of the specified publicly supported organizations for whose benefit it is operated within the meaning of section 509(a)(3)(A). A supporting organization may be “operated, supervised, or controlled by” one or more publicly supported organizations (within the meaning of section 509(a)(3)(B)) and be operated “for the benefit of” one or more different publicly supported organizations (within the meaning of section 509(a)(3)(A)) only if it can be demonstrated that the purposes of the former organizations are carried out by benefiting the latter organizations.

Income Tax Regulations section 1.509(a)-4(h) provides guidance on the meaning of “supervised or controlled in connection with” as follows:

(1) In order for a supporting organization to be “supervised or controlled in connection with” one or more publicly supported organizations, there must be common supervision or control by the persons supervising or controlling both the supporting organization and the publicly supported organizations to insure that the supporting organization will be responsive to the needs and requirements of the publicly supported organizations. Therefore, in order to meet such requirement, the control or management of the supporting organization must be vested in the same persons that control or manage the publicly supported organizations.

(2) A supporting organization will not be considered to be “supervised or controlled in connection with” one or more publicly supported organizations if such organization merely makes payments (mandatory or discretionary) to one or more named publicly supported organizations, even if the obligation to make payments to the named beneficiaries is enforceable under state law by such beneficiaries and the supporting organization's governing instrument contains provisions whose effect is described in section 508(e)(1)(A) and (B). Such arrangements do not provide a sufficient “connection” between the payor organization and the needs and requirements of the publicly supported organization to constitute supervisions or control in connection with such organizations.

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Income Tax Regulations section 1.509(a)-4(i) provides guidance on the meaning of “operated in connection with” as follows:

(1) *General rule*

(i) Except as provided in subdivisions (ii) and (iii) of this subparagraph and subparagraph (4) of this paragraph, a supporting organization will be considered as being operated in connection with one or more publicly supported organizations only if it meets the “responsiveness test” which is defined in subparagraph (2) of this paragraph and the “integral part test” which is defined in subparagraph (3) of this paragraph.

(2) *Responsiveness test*

(i) For purposes of this paragraph, a supporting organization will be considered to meet the “responsiveness test” if the organization is responsive to the needs or demands of the publicly supported organizations within the meaning of this subparagraph. In order to meet this test, either subdivision (ii) or subdivision (iii) of this subparagraph must be satisfied.

(ii)

(a) One or more officers, directors, or trustees of the supporting organization are elected or appointed by the officers, directors, trustees, or membership of the publicly supported organizations;

(b) One or more members of the governing bodies of the publicly supported organizations are also officers, directors or trustees of, or hold other important offices in, the supporting organizations; or

(c) The officers, directors or trustees of the supporting organization maintain a close and continuous working relationship with the officers, directors or trustees of the publicly supported organizations; and

(d) By reason of (a), (b), or (c) of this subdivision, the officers, directors or trustees of the publicly supported organizations have a significant voice in the investment policies of the supporting organization, the timing of grants, the manner of making them, and the selection of recipients of such supporting organization, and in otherwise directing the use of the income or assets of such supporting organization.

(iii)

(a) The supporting organization is a charitable trust under State law;

(b) Each specified publicly supported organization is a named beneficiary under such charitable trust's governing instrument; and

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(c) The beneficiary organization has the power to enforce the trust and compel an accounting under State law.

(3) *Integral part test; general rule*

(i) For purposes of this paragraph, a supporting organization will be considered to meet the "integral part test" if it maintains a significant involvement in the operations of one or more publicly supported organizations and such publicly supported organizations are in turn dependent upon the supporting organization for the type of support which it provides. In order to meet this test, either subdivision (ii) or subdivision (iii) of this subparagraph must be satisfied.

(ii) The activities engaged in for or on behalf of the publicly supported organizations are activities to perform the functions of, or to carry out the purposes of, such organizations, and, but for the involvement of the supporting organization, would normally be engaged in by the publicly supported organizations themselves.

(iii)

(a) The supporting organization makes payments of substantially all of its income to or for the use of one or more publicly supported organizations, and the amount of support received by one or more of such publicly supported organizations is sufficient to insure the attentiveness of such organizations to the operations of the supporting organization. In addition, a substantial amount of the total support of the supporting organization must go to those publicly supported organizations which meet the attentiveness requirement of this subdivision with respect to such supporting organization. Except as provided in (b) of this subdivision, the amount of support received by a publicly supported organization must represent a sufficient part of the organization's total support so as to insure such attentiveness. In applying the preceding sentence, if such supporting organization makes payments to, or for the use of, a particular department or school of a university, hospital or church, the total support of the department or school shall be substituted for the total support of the beneficiary organization.

(b) Even where the amount of support received by a publicly supported beneficiary organization does not represent a sufficient part of the beneficiary organization's total support, the amount of support received from a supporting organization may be sufficient to meet the requirements of this subdivision if it can be demonstrated that in order to avoid the interruption of the carrying on of a particular function or activity, the beneficiary organization will be sufficiently attentive to the operations of the supporting organization. This may be the case where either the supporting organization or the beneficiary organization earmarks the support received from the supporting organization for a particular program or activity, even if such program or activity is not the beneficiary organization's primary program or activity so long as such program or activity is a substantial one.

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(d) All pertinent factors, including the number of beneficiaries, the length and nature of the relationship between the beneficiary and supporting organization and the purpose to which the funds are put (as illustrated by subdivision (iii)(b) and (c) of this subparagraph), will be considered in determining whether the amount of support received by a publicly supported beneficiary organization is sufficient to insure the attentiveness of such organization to the operations of the supporting organization. Normally the attentiveness of a beneficiary organization is motivated by reason of the amounts received from the supporting organization. Thus, the more substantial the amount involved, in terms of a percentage of the publicly supported organization's total support the greater the likelihood that the required degree of attentiveness will be present. However, in determining whether the amount received from the supporting organization is sufficient to insure the attentiveness of the beneficiary organization to the operations of the supporting organization (including attentiveness to the nature and yield of such supporting organization's investments), evidence of actual attentiveness by the beneficiary organization is of almost equal importance. An example of acceptable evidence of actual attentiveness is the imposition of a requirement that the supporting organization furnish reports at least annually for taxable years beginning after December 31, 1971, to the beneficiary organization to assist such beneficiary organization in insuring that the supporting organization has invested its endowment in assets productive of a reasonable rate of return (taking appreciation into account) and has not engaged in any activity which would give rise to liability for a tax imposed under sections 4941, 4943, 4944, or 4945 if such organization were a private foundation. The imposition of such requirement within 120 days after October 16, 1972, will be deemed to have retroactive effect to January 1, 1970, for purposes of determining whether a supporting organization has met the requirements of this subdivision for its first two taxable years beginning after December 31, 1969. The imposition of such requirement is, however, merely one of the factors in determining whether a supporting organization is complying with this subdivision and the absence of such requirement will not preclude an organization from classification as a supporting organization based on other factors.

(e) However, where none of the beneficiary organizations is dependent upon the supporting organization for a sufficient amount of the beneficiary organization's support within the meaning of this subdivision, the requirements of this subparagraph will not be satisfied, even though such beneficiary organizations have enforceable rights against such organization under State law.

Revenue Ruling 76-32, 1976-1 C.B. 160, held that so long as the agreement of the supporting organization to provide reports to the supported organization is observed, it will be considered evidence of actual attentiveness within the meaning of section 1.509(a)-4-(i)(3)(iii)(d) of the Regulations for purposes of determining whether the attentiveness requirement of the integral part test of section 1.509(a)-4(i)(3)(iii) is satisfied. However, while the agreement will be considered evidence of actual attentiveness under section 1.509(a)-4(i)(3)(iii)(d), it will not, in itself, satisfy the attentiveness requirement of the integral part test of section 1.509(a)-4(i)(3)(iii).

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Rather, in order to satisfy that requirement, all of the factors mentioned in the regulations must be taken into consideration.

Income Tax Regulations section 1.509(a)-4(j) regarding control by disqualified persons provides:

(1) *In general.* —Under the provisions of section 509(a)(3)(C) a supporting organization may not be controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more publicly supported organizations. If a person who is a disqualified person with respect to a supporting organization, such as a substantial contributor to the supporting organization, is appointed or designated as a foundation manager of the supporting organization by a publicly supported beneficiary organization to serve as the representative of such publicly supported organization, then for purposes of this paragraph such person will be regarded as a disqualified person, rather than as a representative of the publicly supported organization. An organization will be considered “controlled”, for purposes of section 509(a)(3)(C), if the disqualified persons, by aggregating their votes or positions of authority, may require such organization to perform any act which significantly affects its operations or may prevent such organization from performing such act. This includes, but is not limited to, the right of any substantial contributor or his spouse to designate annually the recipients, from among the publicly supported organizations of the income attributable to his contribution to the supporting organization. Except as provided in subparagraph (2) of this paragraph, a supporting organization will be considered to be controlled directly or indirectly by one or more disqualified persons if the voting power of such persons is 50 percent or more of the total voting power of the organization's governing body or if one or more of the total voting power of the organization's governing body or if one or more of such persons have the right to exercise veto power over the actions of the organization. Thus, if the governing body of a foundation is composed of five trustees, none of whom has a veto power over the actions of the foundation, and no more than two trustees are at any time disqualified persons, such foundation will not be considered to be controlled directly or indirectly by one or more disqualified persons by reason of this fact alone. However, all pertinent facts and circumstances including the nature, diversity, and income yield of an organization's holdings, the length of time particular stocks, securities, or other assets are retained, and its manner of exercising its voting rights with respect to stocks in which members of its governing body also have some interest, will be taken into consideration in determining whether a disqualified person does in fact indirectly control an organization.

GOVERNMENT POSITION:

It is the government’s position that ORG’s tax exempt status should be revoked. Alternatively, it should be reclassified as a private foundation.

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Due to Congressional concerns about wide-spread abuses of their tax-exempt status by private foundations, private foundations were defined and subjected to significant regulations and controls by the Tax Reform Act of 1969. The definition of a private foundation was intentionally inclusive so that all organizations exempted from tax by section 501(c)(3) are private foundations except for those specified in section 509(a)(1) through(4), Roe Foundation Charitable Trust v. Commissioner, T.C. Memo. 1989-566, 58 T.C.M. (CCH) 402, 404 (1989); Quarrie Charitable Fund v. Commissioner, 603 F.2d 1274, 1277 (7th Cir. 1979).

Publicly supported organizations as defined in sections 509(a)(1) and (2) are excepted from private foundation status on the theory that their exposure to public scrutiny and their dependence on public support keep them from the abuses to which private foundations are subject. Supporting organizations are similarly excepted from private foundation status. Supporting organizations are excepted if they are subject to the scrutiny of public charities that provide sufficient oversight to keep supporting organizations from the types of abuses to which private foundations are prone. Quarrie Charitable Fund, 603 F.2d at 1277-78.

IRC § 509(a)(3) organizations must meet all three of the following tests:

- 1) Organizational and Operational Tests under IRC § 509(a)(3)(A).
- 2) Relationship Test under IRC § 509(a)(3)(B).
- 3) Lack of Disqualified Person Control Test under IRC § 509(a)(3)(C).

Overall, these tests are meant to ensure that a supporting organization is responsive to the needs of a public charity and intimately involved in its operations and that the public charity (or publicly supported organization) is motivated to be attentive to the operations of the supporting organization and that it is not controlled, directly or indirectly, by disqualified persons.

Organizational and Operational Test

ORG is not organized to benefit one or more specified publicly supported organizations. Pursuant to Treas. Reg. § 1.509(a)-4(c)(1)(iii) and (iv), an organization's governing instrument must state the specified publicly supported organization(s) on whose behalf the organization is to be operated and cannot expressly empower the organization to support or benefit any organizations other than the specified publicly supported organizations(s).

The Declaration of Trust (and Schedule A thereto) of ORG specifically names the CO-1 and organizations listed on Schedule A as the organizations that will be supported. All of these organizations have received a ruling that they are described in Section 501(c)(3) of the Internal Revenue Code of 1986 and are not a private foundation because they are described in Section 509(a)(1) and 170(b)(1)(A)(vi). The Declaration of Trust mandates annual distributions and restricts those grants to the specified publicly supported charities.

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However, the Trustee has the power to determine the trust corpus is so small to economically administer and can distribute it to any charity he selects. Furthermore, upon dissolution, the trust's assets can be distributed to any public charity. Distributions are not limited to the specified public charities. See Quarrie, supra (holding that the organizational test is not satisfied where the trustee has the power to substitute beneficiaries when, in the judgment of the trustee, the uses of the named beneficiaries become unnecessary, undesirable, impracticable, impossible or no longer adapted to the needs of the public). Thus, the organizational test is not satisfied.

Relationship Test

As set forth in Treas. Reg. § 1.509(a)-4(f)(2), there are three permissible relationships: (a) operated, supervised, or controlled by; (b) supervised or controlled in connection with; and (c) operated in connection with one or more publicly supported organizations.

The relationships "operated, supervised or controlled by" and "supervised or controlled in connection with" presuppose a substantial degree of direction over the policies, programs and activities of the supporting organization by a publicly supported organization. The "operated, supervised or controlled by" relationship is established by the fact that a majority of the officers, directors, or trustees of the supporting organization are appointed or elected by the governing body, members of the governing body, officers acting in their official capacity or the membership of the publicly supported organization. The "supervised or controlled in connection with" relationship is established by the fact that there is common supervision or control by the persons supervising or controlling both the supporting and the publicly supported organizations, i.e., that control or management of the supporting organization is vested in the same persons that control or manage the publicly supported organization.

In the present case, the facts indicate that none of the five board members was appointed by the publicly supported organization, the CO-1. Therefore, the requirements to meet one of the first two types of relationship are not met.

The 3rd and final relationship possible for section 509(a)(3) organizations is the "operated in connection with" relationship which requires that the supporting organization be responsive to the needs or demands of the publicly supported organization and constitute an integral part of, or maintain a significant involvement in the affairs of the publicly supported organization. This relationship is satisfied where the supporting organization meets both the "responsiveness" and "integral part" tests. Neither test has been met in this case.

ORG does not satisfy the responsiveness test. In order to meet the responsiveness test, either Treas. Reg. § 1.509(a)-4(i)(2)(ii) or (iii) must be satisfied. Income Tax Regulations section 1.509(a)-4(i)(2)(ii) requires a supporting organization to demonstrate that one or more of the

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officers, director or trustees of the supporting organizations either (a) be appointed or elected by specified representatives of the publicly supported organizations or (b) be members of the governing body of the publicly supported organizations or (c) maintain a close and continuous working relationship with the officers, directors or trustees of the publicly supported organizations. There is no evidence that the officers, directors or trustees of ORG satisfy any of these relationships. Even if such a relationship existed, by virtue of the relationship the officers, directors or trustees of the publicly supported organizations would have to have a significant voice in the investment policies of the supporting organization, the timing of grants, the manner of making grants, the selection of recipients by the supporting organization and in otherwise directing the use of the income or assets of the supporting organization. There is no evidence that the CO-1 has a significant voice in ORG's operations. The board did not exercise oversight – it did not meet.

If this test is not met, there is a second way to satisfy the responsiveness test that is set forth in Income Tax Regulations section 1.509(a)-4(i)(2)(iii). The second method requires that (a) the supporting organization be a charitable trust under state law; (b) each specific publicly supported organization be a named beneficiary under the trust's governing instrument; and (c) the beneficiary organization have the power to enforce the trust and compel an accounting under state law. The Declaration of Trust requires the trustee to distribute 35% of the net income of the trust to the CO-1 and a total of 50% of the net income to one or more of the organizations listed on Schedule A. There are over 80 organizations listed on Schedule A that the trustee can select as grant recipients. Only the CO-1 is entitled to receive a specified portion of the Foundation's net income. The Foundation is not required to make any specified distributions to any of the other organizations. Therefore, the Foundation has not established that any of these organizations are beneficiaries to the trust or that they have the power to enforce the trust under state law. Thus this test is also not satisfied by ORG.

While the responsiveness test guarantees that the publicly supported organization can influence the activities of the supporting organization, the integral part test ensures that the publicly supported organization will be motivated to attend to the operations of the supporting organization. The integral part test is considered to have been satisfied if the supporting organization maintains a significant involvement in the operations of one or more publicly supported organizations and the publicly supported organizations are in turn dependent upon the supporting organization for the type of support which it provides. Treas. Reg. § 1.509(a)-4(i)(3)(i). In order to meet the integral part test, either Treas. Reg. § 1.509-4(i)(3)(ii) or (iii) must be satisfied.

Treas. Reg. § 1.509(a)-4(i)(3)(ii) provides that the activities engaged in for or on behalf of the publicly supported organizations must be activities to perform the functions of, or to carry out the purposes of, such organizations and, but for, the involvement of the supporting organization, would normally be engaged in by the publicly supported organizations themselves. Thus, this

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part of the integral part test applies in those situations in which the supporting organization actually engages in activities which benefit the publicly supported organizations as opposed to simply making grants to support the publicly supported organizations. See Roe Foundation, 58 T.C.M. at 408; Cuddeback Foundation v. Commissioner, T.C. Memo. 2002-300. ORG does not meet this test because it does not perform any activities the publicly supported organizations conduct themselves.

Because the Organization did not perform any activities for or on behalf of publicly supported organizations that the publicly supported organizations would otherwise perform themselves, the applicable rules for satisfying the integral part test are in Treas. Reg. § 1.509(a)-4(i)(3)(iii). This section of the regulation has the following 3 basic requirements: 1) payment of substantially all of its income to publicly supported organizations; 2) the amount received by one publicly supported organization must be sufficient to motivate it to pay attention to the operations of the supporting organization; and 3) a substantial amount of the total support of the organization must go to those publicly supported organizations that meet the attentiveness requirement. The second requirement is not satisfied so the third requirement cannot be satisfied.

The Organization had no income during the years under examination so the first requirement is moot.

Treas. Reg. § 1.509(a)-4(i)(3)(iii)(a) provides that the amount of support received by a publicly supported organization must represent a sufficient part of the organization's total support so as to insure such attentiveness. Treas. Reg. § 1.509(a)-4(i)(3)(iii)(b) provides that a supporting organization can meet the attentiveness requirement, even where the amount of support received by the publicly supported organization does not represent a sufficient part of the publicly supported organization's total support, if it can be demonstrated that support is earmarked for a substantial program of the publicly supported organization that would be interrupted without the supporting organization's support. And finally, Treas. Reg. § 1.509(a)-4(i)(3)(d) provides that "all pertinent factors. . . will be considered in determining whether the amount of support received by a publicly supported organization is sufficient to insure the attentiveness of such organization to the operations of the supporting organization. It goes on to note the importance of the percentage of the income received from the supporting organization is in determining if the publicly supported organization will have the requisite degree of attentiveness and concludes that evidence of actual attentiveness is almost as important.

The Organization did not make any grants to the CO-1 or any other public charity during the years under examination. Receiving -0- is not sufficient to motivate a public charity to be attentive to the Organization's operations.

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Furthermore, the facts show the CO-1 was not attentive to the operations of the Organization. The board members of ORG have not met with the CO-1's board members to discuss the specific needs of the CO-1. The CO-1 was not involved in determining the investment strategies and options and the amount of the grants. The CO-1 did not appoint a board member to represent it. There is no evidence that the CO-1 inquired about the lack of grants or reasons therefor.

Taking into consideration all pertinent factors, the amount of support provided to the CO-1 by ORG was insufficient to ensure its attentiveness.

Control Test

Internal Revenue Code § 509(a)(3)(C) and Treas. Reg. § 1.509(a)-4(j)(1) provides that a supporting organization may not be controlled, directly or indirectly by disqualified persons. Trustee and Donor are substantial contributors to ORG and are, therefore, disqualified persons to ORG.

There are five members of the Board of Directors of ORG. The board of ORG have never met to approve the grants and investment activity. Therefore, the founders, Trustee and Donor, disqualified persons, exercised total control in determining who would be grant recipients and in determining the investment strategies. The board exercises no oversight.

Conclusion

ORG alternatively should be reclassified as an organization that is a private foundation defined in section 509(a), effective January 1, 20XX. ORG should not be classified as a supporting organization because it has not established that it has met the requirements set forth in Treas. Reg. § 1.509(a)-4(c) through (j).

The effect of this determination will be that the Organization is required to file Form 990-PF Return of Private Foundation. Form 990-PF should be filed for tax years ending December 31, 20XX through December 31, 20XX. Subsequent returns are due no later than the 15th day of the 5th month following the close of the Organization's accounting period.

Send your returns to the following mailing address:

Note: Form 990-PF is required for each year until Private Foundation status is terminated under IRC § 507.



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service

August 14, 2007

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 propose modifying your private foundation status under section 509(a) of the Internal Revenue Code (Code).

Your exempt status under section 501(c)(3) of the Code is still in effect.

If you accept our findings, take no further action. We will issue a final letter modifying your private foundation status.

If you do not agree with our proposed modification of private foundation status, you may provide additional information that you would like to have considered, or you may submit a written appeal. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organization 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.

If you request a conference with Appeals, you must submit a written protest within 30 days from the date of this letter. 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.

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 letter.

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 3498
Publication 892
Report of Examination