



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

TE/GE: EO Examination

625 Fulton Street, Room 503

Brooklyn, NY 11201

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: September 2, 2008

UIL:501.03-01

Release Number: 200850042

Release Date: 12/12/08

Legend

ORG = Organization name

XX = Date

Address = address

ORG
ADDRESS

Taxpayer Identification Number

Person to Contact:

Identification Number

Contact Telephone Number:

LAST DATE FOR FILING A PLEADING
WITH THE TAX COURT, THE CLAIMS
COURT, OR THE UNITED STATES
DISTRICT COURT FOR THE
DISTRICT OF COLUMBIA:
December 1, 20XX

Dear

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

IRC 501(c)(3) exempts from taxation organizations which are organized and operated exclusively for charitable or educational purposes, no part of the net earnings of which inure to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation and which do not participate in, or intervene in, any political campaign on behalf of (or in opposition to) any candidate for public office.

We have determined that you are not operating exclusively for any charitable purpose, educational purpose, or any other exempt purpose. Our examination reveals that you are not engaged primarily in activities which accomplish charitable, educational or other exempt purposes as required by Treas. Reg. 1.501(c)(3)-1(c)(1). Your activities, including your financial transactions, more than insubstantially furthered non-exempt purposes. Moreover, you failed to establish that you were not operated for the benefit

of private interests of your founder and principal officer, as required for continued recognition of exemption pursuant to Treas. Reg. 1.501(c)(3)-1(d)(1)(ii).

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

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code.

You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for all years beginning January 1, 20XX.

Processing of income tax returns and assessment of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Internal Revenue Code.

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

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

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

Enclosure:
Publication 892

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer:	EIN:	Year/Period Ended
ORG		20XX12

LEGEND

ORG = Organization name XX = Date XYZ = State City = city
 motto = motto CM-1 & CM-2 = 1st & 2nd CM FAIR-1, FAIR-2, FAIR-3 & FAIR-4 = 1st, 2nd, 3rd & 4th FAIR EMP-1 & EMP-2 = 1st & 2nd EMP Secretary = secretary Director = director WK-1 = 1st WK CO-1 thru CO-31 = 1st, 2nd, 3rd, 4th, 5th, 6th, 7th, 8th, 9th, 10th, 11th, 12th, 13th, 14th, 15th, 16th, 17th, 18th, 19th, 20th, 21st, 22nd, 23rd, 24th, 25th, 26th, 27th, 28th, 29th, 30th & 31st companies Payer-1 thru Payer -12 = 1st, 2nd, 3rd, 4th, 5th, 6th, 7th, 8th, 9th, 10th, 11th & 12th Payer Payee-1 = 1st payee

Issue

Is ORG operating exclusively for Motto, charitable, and educational, purposes described in Internal Revenue Code (IRC) § 501(c)(3) in which no part of its net earnings inure to the benefit of any private shareholder or individual?

Facts

Organizing documents

ORG (referred to as the “organization” was formed on January 19, 20XX for purposes within the meaning of IRC § 501(c)(3). The Service recognized the Foundation as an organization exempt from tax as an organization described in section 501(c)(3), and classified it as a publicly supported organization described in section 509(a)(1), in a determination letter dated May 20XX.

The Articles of incorporation state that the organization’s specific purpose in Article II (B): “Community sports activity - conducting clinics, workshops, lessons, and seminars at municipal parks and recreational areas to instruct and educate individuals in a particular sport is operated exclusively for educational purposes and qualifies for exemption under IRC 501(c)(3).” Article II (C): “Said organization is organized exclusively for charitable, motto, and scientific purposes, including for such purposes, the making of distributions to organizations, that qualify as exempt organizations under section 501(c)(3) of the Internal Revenue Code...” The Articles include all the clauses required under IRC 501(c)(3), including the prohibition on inurement of any part of the net income or assets of the corporation to any director, officer, member thereof.

The Organization and Affiliated Entities

The Organization’s board consisted of BM-1, who also goes by the name BM-1, BM-3, and BM-2.

Organization’s Form 1023 Application

On February 11, 20XX, ORG applied to the Service for exemption under IRC § 501(c)(3).

The organization stated on its application that its proposed activities will be “Ministry services conducted by BM-3 BM-1 Building Gods church, healing the sick, and teaching financial

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prosperity spiritually, mentally, and physically. Internet website to teach, communicate, and worship nationally and worldwide [sic].”

Part II, Question 2, what are or what will be the sources of financial support? The Organization responded “membership donations, marketing for contributions, sales of CD’s and tapes. In Question 3, the Organization described that its fundraising program was its “Website sell of CD’s and tapes, consultant BM-2 [sic]”

On its application, Form 1023 page 3, the Organization stated its governing body was BM-1, Pres., BM-3, Secretary, BM-2, Director. The Organization listed on its application that the officers’ annual compensation was “n/a”.

The Service sent Letter 1312 from the Organization on March 22, 20XX, stating that the Form 1023 application was incomplete and the Service needed more information to verify that the legal requirements for exemption have been met.

The letter requested:

conformed copy of Articles of Incorporation that have been filed with the State of XYZ. Amended the Articles (approved by of filed with the proper state official). The organizational document submitted by ORG did not meet the organizational test of Section 501(c)(3). A list of questions regarding the organization’s church status (on 5/4 t service received a fax from the organization seeking public charity status as opposed to church status.) A chronology and complete description of all past activities of your organization as well as activities planned for the next three years. (the information submitted did not contain sufficient detail to fully describe proposed activities.) Describe in detail how you carry on or plan to carry on your motto activities by priests, prophets, pastor, ministers, in forums, by radio or television, through recorded or print media, and the internet. State whether your organization has audio, video, or literature of its own. State how your recording and publishing activities further your exempt purpose. State how your recording or publishing activities are distinguishable from for-profit enterprises. State whether your video or literature is distributed free of charge, if not what is used to determine the sales price. Describe your method of distribution for literature and videos. Indicate whether your video or literature will be copyrighted. If so, whose the copyright held by?

Agent was unable to obtain any response to the above questionnaire.

Form 990

The Organization did not file a form 990 for the 20XX tax year.

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The Service mailed Letter 4041 on February 21, 20XX to the Organization asking for it to complete Form 13770, *Credit Counseling and Form 990 Filing Requirements*. The Organization reported its gross receipts were for one year or less \$ and reported total assets \$.

Organization's Revenues and Activities in 20XX

Motto:

The organization and BM-1 (BM-1), received the following payments for creating and maintaining websites for for-profit businesses:

Payer	Amount	Payee	Date	Check
Payer-1	\$	BM-1	1/31/20XX	Computer Work
Payer-1	\$	BM-1	3/1/20XX	Computer Work
Payer-1	\$	BM-1	3/15/20XX	Website
Payer-1	\$	BM-1	5/4/20XX	Computer Work
Payer-1	\$	BM-1	11/1/20XX	Computer Work
Payer-1	\$	BM-1	12/12/20XX	
Payer-2	\$	Payee-1	8/23/20XX	Web-site
Payer-3	\$	Payee-1	1/11/20XX	Motto
Payer-3	\$	Payee-1	5/11/20XX	Website
Payer-3	\$	Payee-1	8/19/20XX	Web work
Payer-4	\$	Payee-1	1/31/20XX	Website
Payer-5	\$		7/28/20XX	
Payer-4	\$	Payee-1	10/12/20XX	Hosting
Payer-4	\$	Payee-1	12/12/20XX	Final Payment
Payer-6	\$		1/21/20XX	
Payer-6	\$	Payee-1	3/7/20XX	March Motto
Payer-6	\$		Cash	
Payer-7	\$	Payee-1	6/14/20XX	Website
Payer-7	\$	Payee-1	7/22/20XX	Website
Payer-7	\$	Payee-1	10/12/20XX	Website
Payer-7	\$	Payee-1	12/7/20XX	payment
Payer-8	\$	Payee-1	8/15/20XX	Web-site
	<u>\$</u>			

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CO-1 (CO-1:

The CO-1 (XYZ) is a program that allows low-income households a reduced energy bill (up to 20%). CO-1 contracted with ORG. ORG's would hand out pamphlets and also assist individuals complete the CO-1 application. The Organization was to be paid a capitation fee for each new customer enrolled in the program.

The Organization shared booths with CO-1 and distributes pamphlets for the CO-1 at fairs. The fairs that the Organization handed out pamphlets were: FAIR-1, FAIR-2, FAIR-3, FAIR-4. The Organization also mailed out pamphlets.

The organization also submitted a copy of one television broadcast (on DVD) that it produced for the CO-1. The DVD consists of BM-1 and EMP-1, supervisor of the CO-1, discussing the program and how to qualify for the program and two advertisements for ORG. The discussion is approximately 17 minutes. Next on the DVD is a gospel music video of EMP-2 performing. This segment lasts approximately six minutes. The video then solicits volunteers and donations of "love offerings" followed by an advertisement for ORG's multimedia services: motto, motto, and email list distribution with the organization giving reference cites. The total length of the DVD was 27 minutes and 39 seconds. The camera men for the video was CM-1 and CM-2.

The organization also submitted a DVD containing a public service announcement it produced for channel in the Citu for Black History Month Celebration. The announcement was 34 seconds.

The organization also stated that the organization conducted internet broadcast, but has not shown this internet broadcast activity to the Service. The Organization stated that the broadcast aired on CO-2 to \$ subscribers and production and airing cost was \$ plus the video camera receipt. The organization has not shown any documentation to the Service to sustain its claim that the production cost was \$. The invoice provided shows that the camera was paid for in cash for \$ on December 20, 20XX. The camera purchase is not reflected in the organization's bank statements.

The Organization's receipts for the CO-1:

CO-1	\$		1/21/20XX	CO-1
CO-1	\$	Payee-1	3/22/20XX	CO-1
CO-1	\$	Payee-1	3/31/20XX	CO-1
CO-1	\$		4/19/20XX	CO-1
CO-1	\$	Payee-1	6/17/20XX	CO-1
CO-1	\$	Payee-1	7/20/20XX	CO-1

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CO-1	\$	Payee-1	8/19/20XX	CO-1
CO-1	\$		9/21/20XX	CO-1
CO-1	\$		11/22/20XX	CO-1
CO-1	\$	Payee-1		CO-1
	\$			

The organization had links on its website (during the year under audit and currently) for services that are unrelated to its exempt purpose: offering music CD's (11 in total ranging from \$ to \$), web services (motto, Motto, Motto, and 5 different email services).

The organization also accepted donations (cash and non-cash items) on its website and sold an EBook authored by BM-1: . BM-1 stated to the Service that the organization did not have any CD sales in 20XX, that it stopped online transactions in 20XX despite the fact that the services are still present on the website.

According to BM-1, other activities conducted by the organization include:

BM-1 spoke at youth graduation for basketball players approximately six times,

Held approximately four seminars on restoring credit. Credit seminars are held at CO-3 and are community events telling about the basics of credit,

Book – - building and repairing credit Score. Only available in e-book form. The book is available on the website in CD format for \$. The book is available for purchase/donation request, however those who were unable to donate were given the book for free during the seminar,

Meditation - non traditional ministry services on a spiritual level.

The organization received vehicle donations – (per the initial interview) approximately 12 vehicles in 20XX totaling \$. Payee-1 is contracted with . has a list of nonprofits. Individuals donating their vehicle choose which nonprofit will receive the donation / funds .

The actual receipts per the bank statements show that the organization received only \$ from :

Payer	Amt	Payee	Date
	\$	Payee-1	6/7/20XX
	\$	Payee-1	8/19/20XX
	\$	Payee-1	11/10/20XX

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\$ Payee-1 12/6/20XX
\$
\$ Payee-1 4/5/20XX

Revenues (other):

The organization receives donations from the public in the form of cash or check.

Payer	Amt	Payee	Date	Purpose
CM-1	\$		1/20/20XX	Rent Utility Bill
CM-1	\$	BM-1	1/28/20XX	Rent/
CM-1	\$	BM-1	3/2/20XX	March Rent
CM-1	\$	BM-1	4/4/20XX	April Rent
CM-1	\$	BM-1	5/2/20XX	May Rent
CM-1	\$	BM-1	6/1/20XX	Rent
	\$			

The organization has not explained to the Service why BM-1 was receiving rent payments or what activity was conducted to generate rent income and how such activity furthered its exempt purpose.

Payer	Amt	Payee	Date #	Purpose
Payer-9	\$	BM-1	4/15/20XX	Funeral BM-3 Escrow

The organization has not explained to the Service why this check was paid to BM-1, and how this activity furthered its exempt purpose.

Payer	Amt	Payee	Date	#	Memo	Explanation
Payer-10	\$	Payee-1	8/3/		Business	"credit tutoring"
			4/15/			
CO-4	\$	BM-1	4/19/		Loan	Web Loan
Payer-11	\$	BM-1	1/20/			Donation
Payer-9	\$	BM-1				Donation
Payer-12	\$	BM-1	4/22/		Love Offering	Donation

The organization has not explained to the Service why services and donations were paid to BM-1 rather than ORG. The organization did not fully explain what services constitute "credit tutoring" for check number for \$.

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CM-2	\$	Payee-1	1/14/20XX	Donation
CO-5	\$	Payee-1	9/21/20XX	TV ad

The following are escrow payments and 'loans' made by BM-1 to the org in which no contracts exist. The loans were purportedly used for general expenses, purchase of supplies, upgrades, equip, stated in the minutes that they are for 15 years at no interest.

BM-1 ¹	\$	Loan	8/29/20XX	
BM-1	\$	Donation	9/14/20XX	
BM-1	\$ (cash)	Funeral BM-3 Escrow	10/14/20XX	
BM-1	\$	Loan	10/19/20XX	
BM-1	\$ (cash)	Loan	10/28/20XX	
BM-1	\$ (cash)	Loan	12/8/20XX	
BM-1	\$ (cash)	Loan	12/12/20XX	
	\$			
BM-2	\$	Payee-1	1/18/20XX	Loan
BM-2	\$	Payee-1	2/11/20XX	Loan
BM-2	\$	Payee-1	3/11/20XX	Donation
BM-2	\$	Payee-1	4/11/20XX	Loan
BM-1	\$	Payee-1	5/11/20XX	Loan
BM-1	\$		5/11/20XX	Cash Loan
BM-1	\$	Payee-1	6/14/20XX	Loan
BM-1	\$	Payee-1	7/6/20XX	Loan
BM-1	\$	Payee-1	9/23/20XX	Loan
BM-2	\$	Payee-1	3/7/20XX	Loan
	\$			

BM-1 informed the Service that the organization did not pay him a salary and that BM-1 spent his time full-time with the organization and did not have any other job or employment. The source of money constituting the loans to the organization are from real estate mortgage loans from property owned by BM-1.

The money was used from escrow to pay for the funeral of BM-3

Organization's Expenses in 20XX

The Organization's bank statements for checking CO- checking account revealed the following expenses:

* * * *

¹ Check number from CO-31, was paid to BM-1, Trustee totaling \$ for "CO-32"

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Bank Card payments:

Payee	Total	
CO-6	\$	
Credit cards		\$ (personal credit cards)
Gas		\$
CO-7		\$
CO-8	\$	
CO-9		\$
CO-10		\$
CO-11	\$	
CO-12		\$
CO-13		\$
CO-14	\$	
CO-15		\$
Counter Withdrawals:	Total	Date
Counter Check	\$	4/4/20XX
Counter Check	\$	8/31/20XX
ATM Withdrawals:	\$	throughout the year
Checks:		
Payee	Total	
BM-1	\$	8/30/20XX

Tax Collector

Parcel \$ Check number

Check number was for property Tax for address, City, XYZ, BM-1's personal address.

CO-2	\$	
CO-16.		
CO-17		\$
CO-1		\$
CO-18		\$
CO-19	\$	
CO-20		\$
CO-23	\$	
CO-21		\$
CO-22	\$	
Unknown	\$	Check number dated 3/2/20XX

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Form 4564, Information Document Request (IDR) 02, was mailed to the organization on June 25, 20XX asking the organization to *provide the purpose of each expense, and how did each expense further the organization's exempt purpose? Provide supporting documentation.* The organization did not provide any supporting documentation in the form of receipts or any other contemporaneous substantiation to show how these expenditures further the organization's exempt purpose. The organization's response to the IDR was a resolution of Board of Directors of ORG, Inc, which simply stated that "the Treasurer of this corporation is hereby authorized and directed to reimburse BM-1, President, for moneys advanced and expensed incurred and paid for by and in connection with the proper business purposes of this corporation."

The only substantiation provided by the organization include a receipt from CO-24 for a vault purchase for \$ an invoice from WK-1 for \$ regarding CO-25, receipt from CO-26 for \$, all of which do not relate to the organization's exempt purpose. The organization did provide a receipt for cash purchase for a camera and equipment from CO-27 for \$, however, this expenditure is not reflected in the organizational expenses listed above in this report.

The organization The Organization has not shown to the Service that these expenditures furthered its exempt purpose.

Law:

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.

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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.

Treas. Reg. §1.501(a)-1(c) defines a private shareholder or individual as those persons having a personal and private interest in the activities of an organization. In general, a private shareholder or individual is considered an "insider" with respect to the exempt organization.

Section 1.6033-2(i)(2) of the Income tax regulations provides that "Every organization which is exempt from tax, whether or not it is required to file an annual information return shall submit such additional information as may be required by the Internal Revenue Service for the purpose in inquiring into its exempt status and administering the provisions of subchapter F (section 501 and following), chapter 1 of subtitle A of the Code...."

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

Unitary Mission Church of Long Island, Petitioner v. Commissioner of Internal Revenue, Respondent 74 TC 507, Filed June 3, 1980--The court found: "Net earnings benefited private individuals.]--Petitioner's financial decisions are controlled by X, one of petitioner's ministers, and his wife. X received widely fluctuating 'parsonage allowances' over a three year period as compensation for leading Sunday services and for being available for pastoral counseling. There is no evidence in the administrative record of any differing duties that he performed over these years. Held, petitioner is not entitled to exemption from Federal taxation under secs. 501(a) and 501(c)(3), I.R.C. 1954, as amended, because a part of its net earnings inures to the benefit of private shareholders or individuals".

People of God Community, Petitioner v. Commissioner of Internal Revenue, respondent 75 TC 127, Filed October 14, 1980- The tax court decided that a portion of gross earnings inured to the benefit of private shareholders or individuals. The court stated: "An organization will qualify under section 501(c)(3) only if (1) it is organized and operated exclusively for exempt purposes,

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- (2) no part of its net earnings inures to the benefit of any private shareholder or individual, and
(3) it devotes no substantial part of its activities to political or lobbying activity...

Respondent argues that petitioner's loan policies and ministers' compensation each demonstrate both private inurement of net earnings and prohibited private purposes. While not necessarily identical, the prohibitions against private inurement and private purposes overlap to a great extent ... we will confine our discussion herein to the private inurement issue....

...The burden falls upon petitioner to establish the reasonableness of the compensation paid to Donhowe and petitioner's other ministers. *Bubbling Well Church of Universal Love Inc. v. Commissioner* [Dec. 36,999], 74 T.C. 531 (1980). Petitioner has failed to do so inasmuch as the record on this point contains little more than conclusory assertions and the fact that Dowhowe's compensation was partly based on his personal needs. Moreover, the method by which ministers' compensation was determined shows clearly that a part of petitioner's net earnings was paid to private shareholders or individuals."

In *Founding Church of Scientology v. U.S.*, 412 F.2d 1197 (Ct. Cl. 1969), a wide variety of devices were employed, including fees, commissions, excessive rental payments, loans and excessive salaries, to divert the organization's funds to its founder, L. Ron Hubbard, and his immediate family. The principle of inurement was summarized when the Court stated, "what emerges from these facts is the inference that the Hubbard family was entitled to make ready personal use of the corporate earnings."

In *John Marshall Law School v. U.S.*, 81-2 U.S.T.C. 9514 (Ct. Cl. 1981), in which the Court found that the Commissioner acted properly in revoking exemption under IRC 501(c)(3) on the grounds of inurement to the controlling officers and their families. The inurement included, but was not limited to, payments to the families as follows: automobile, education and travel expenses, insurance policies, basketball and hockey tickets, membership in a private eating establishment, membership in a health spa, interest-free loans, home repairs, personal household furnishings and appliances, and golfing equipment.

In *Texas Trade School v. Commissioner* 30 TC 642, Filed June 18, 1958 [1939 Code Sec. 101(6)--same as 1954 Code Sec. 501(c)(3)] Under "Opinion" the judge stated:
"Section 101(6) of the Internal Revenue Code of 1939, in so far as here material, provides for exemption from taxation of corporations organized and operated exclusively for educational purposes "no part of the net earnings of which inures to the benefit of any private shareholder or individual."

The respondent determined that the petitioner was not entitled to exemption from taxation under Section 101(6) for the years ended May 31, 1947 and May 31, 1948. The basis of his determination was that five individuals, members of the Jennings group, shared in petitioner's

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net earnings as the result of the payment to them of excessive and unreasonable rent for real estate leased to or used by petitioner and as the result of the construction by petitioner of buildings and improvements which attached to and became part of their real estate. The burden of proving that the respondent erred in his determination was on the petitioner. It has not sustained this burden.”

In US-CT-APP-5, [60-1 USTC ¶9371], Birmingham Business College, Inc.; John Ike Griffith; Hulon A. Spears and Audrey Spears; Carl B. Carter and Jewell Carter, and Jewell Carter, Petitioners v. Commissioner of Internal Revenue, Respondent , (Apr. 04, 1960); The court found that: “Taxpayer, an incorporated business college owned and operated by a brother and two sisters, was not a tax-exempt educational ... Substantial portions of its net earnings were distributed to its owner-operators for their personal benefit.”

In US-CT-APP-8, [63-1 USTC ¶9200], Cleveland Chiropractic College, a Corporation, Petitioner v. Commissioner of Internal Revenue, Respondent,--, (Jan. 17, 1963) Affirming Tax Court, 21 TCM 1, Dec. 25,299(M), T. C. Memo. 1962-1 [1939 Code Sec. 101(6)--similar to 1954 Code Sec. 501]--The court found: “A college was not entitled to exemption from corporate income tax for 1948-1951 where part of the net earnings of the college was found to have inured to the benefit of one of its trustees through payment of his personal expenses.”

Revenue Ruling 73-127, 1973-1 CB 221, (Jan. 01, 1973)

A nonprofit organization that operates a cut-price retail grocery outlet and allocates a small portion of its earnings to provide on-the-job training to hard-core unemployed does not qualify for exemption from income tax.

Advice has been requested whether the activities of the organization described below qualify for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954 where the organization otherwise qualifies for such exemption.

The organization was formed to operate a retail grocery store to sell food to residents of a poverty area at prices substantially lower than those charged by competing grocery stores, to provide free grocery delivery service to residents who need it, to participate in the Federal food stamp program, and to provide job training for unemployed residents

The store is operated by a staff of employees experienced in the retail food industry. The store is operated in a manner similar to profit-making businesses in the area, but has a smaller markup than the competing stores. The organization is organized as a nonprofit corporation and no individual has any proprietary interest in its earnings. The store’s gross earnings are used principally to pay salaries and other customary operating expenses incurred in the operation of a retail grocery store and to expand the operations of the store. About two percent of earnings is retained as surplus, to be used as a contingency reserve.

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About four percent of the store's earnings is allocated for use in a continuous training program for the hard-core unemployed. The organization selects only individuals from the hard-core unemployed of the poverty area for training in the various jobs in a retail food store. The training program includes lectures, demonstrations of retail store techniques, and on-the-job training. A trainee receives a small salary during the training period. At the conclusion of his training, he is qualified for employment in the retail food industry. The organization does not plan for the majority of the trainees to continue as its employees. Rather, they are expected to seek employment elsewhere in the retail food industry and new trainees are selected for the program.

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of organizations organized and operated exclusively for charitable or educational purposes.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that to be exempt an organization must be both organized and operated exclusively for one or more exempt purposes.

Section 1.501(c)(3)-1(d)(2) of the regulations defines the term "charitable" as used in section 501(c)(3) of the Code as including the relief of the poor and distressed or of the under-privileged and the advancement of education.

Section 1.501(c)(3)-1(d)(3)(i)(a) of the regulations defines the term "educational" as including the instruction or training of the individual for the purpose of improving or developing his capabilities.

The organization's purpose of providing job training for the hard-core unemployed is charitable and educational within the meaning of the common law concept of charity, section 501(c)(3) of the Code, and sections 1.501(c)(3)-1(d)(2) and 1.501(c)(3)-1(d)(3)(i)(a) of the regulations. However, the organization's purpose of operating a retail grocery store where food is sold to residents of a poverty area at low prices is not recognized as a charitable purpose under the basic common law concept of charity and within the meaning of section 501(c)(3) of the Code and section 1.501(c)(3)-1(d)(2) of the regulations.

Although the nature of the job training in this case is primarily "on-the-job" training and thus requires the existence of an operating business as its "campus," the size and manner of the food store operation and the facts relating to the actual purpose of the undertaking evidence that the operation of the store as a low cost retail grocery outlet is in itself an independent objective of the organization. This is true notwithstanding that the store operation is used in part as a vehicle for the training program. It is conducted on a scale larger than is reasonably necessary for the performance of the organization's training program and was not intended to, nor does it in fact, serve solely as a vehicle for carrying out the training program of the organization.

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Neither may the store operation be characterized as an investment or business undertaking for the production of income for use in carrying on qualified charitable purposes of the organization. The facts show that such is not the purpose of the undertaking, but that the store is operated in part for the purpose of providing a low cost retail grocery outlet in the community as an end in itself.

Thus, it is concluded that operation of the store and operation of the training program are two distinct purposes, that is, ends or objects sought to be accomplished by the organization through use of its resources. Since the former purpose is not a recognized charitable purpose, the organization is not organized and operated exclusively for charitable purposes.

Accordingly, it is held that the organization does not qualify for recognition of exemption from Federal income tax under section 501(c)(3) of the Code.

Rev. Rul 59-95, An organization previously held exempt from Federal income tax was requested to produce a financial statement as of the end of the year and a statement of its operations during such year. However, its records were so incomplete that it was unable to furnish such statements. Section 6033 of the Internal Revenue Code of 1954 provides that every organization, except as provided therein, exempt from taxation under section 501(a) of the Code shall file an annual return, stating specifically the items of gross income, receipts, and disbursements, and shall keep such records, render under oath such statements, make such other returns and comply with such rules and regulations as the Secretary of the Treasury or his delegate may from time to time prescribe. Held, failure or inability to file the required information return or otherwise to comply with the provision 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 an exempt status.

Taxpayer's Position
Is yet to be received

Government's Position

Is ORG operating exclusively for public, charitable, and educational purposes described in Internal Revenue Code (IRC) § 501(c)(3) in which no part of its net earnings inure to the benefit of any private shareholder or individual?

The Government contends that ORG failed the operational test of IRC 501(c)(3) on the following grounds:

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ORG's earnings inured to the benefit of its private shareholders, and a substantial part of the organization's activities are in the furtherance of non exempt activities, thus it did not operate exclusively for one or more exempt purposes as required under Treas. Reg. 1.501(c)(3)-1(c)(2). ORG's key officer and shareholder is BM-1, as he meets the definition of such under Treas. Reg. §1.501(a)-1(c) because he is a "person having a personal and private interest in the activities of an organization." BM-1 devoted all of his time to the organization and was not an employee nor did he received any salary or compensation from the organization. The organization did not file any W-2 or Forms 1099-MISC on behalf of BM-1.

ORG's earnings inured to its shareholders by way of:

(1) paying the organization's funds for the personal expenses of its shareholder, BM-1. ORG paid BM-1's personal credit card expenses totaling \$, property tax payment for BM-1's personal residence totaling \$, CO-6 for personal use \$, bank counter withdrawals totaling \$, ATM Withdrawals totaling \$ throughout the year, check payable to the key officer BM-1 for \$ on 8/30/20XX, and the following other miscellaneous expenses:

CO-2	\$		
CO-16.			
CO-17	\$	CO-22	\$
CO-1	\$		
CO-18	\$	Unknown (# dated 3/2/	\$
CO-19	\$		
CO-20	\$		
CO-23	\$		
CO-21	\$		

The Service asked the organization to show how each of these expenditures furthered the organization's exempt purpose, and the organization was unable to show the Service any contemporaneous substantiation or the purpose of these expenses. Thus, ORG operated in a way that was comparable to the organizations described in Birmingham Business College, Cleveland Chiropractic College, and Texas Trade School ,and;

(2) The organization engaged in substantial activities that were unrelated to the organization's exempt purpose.

(a) The organization's web services generated \$ and is unrelated to the organization's exempt purpose. The web services consisted of maintaining websites for local businesses. The web services represent 8.66% of the organization's activities.

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(b) The organization also received \$ from Check number from CO-31, which was payable to BM-1, Trustee totaling \$ for "CO-32" and deposited into ORG. However, BM-1 stated this amount was a loan to the organization. The organization also received cash from BM-1 totaling \$ for Funeral BM-3. It appears these two amounts were earmarked for the funeral expenses. The receipts provided relating to the funeral totaled \$ (\$ vault, \$ – attorney, \$ funeral services) or 39.88% of the organization's total expenses and 34.9% of the organization's gross receipts.

The organization's gross receipts were \$ for 20XX. Although BM-1 asserts that the amounts he 'loaned' to the organization were in fact loans, the mere declaration that the funds were intended on being loans is insufficient since the transaction fails to exhibit reliable indicia of debt. See *Williams v. Commissioner*, 627 F.2d 1032, 1034 (10th Cir. 1980). There was no promissory note or other evidence of indebtedness, no interest charged, no security or collateral, no records maintained. See *Vinikoor v. Commissioner*, TC Memo 1998-152. The Service contends that these amounts should have been included in the organization's gross receipts in which ORG would be liable for filing a Form 990.

Conclusion

As described above, ORG's recognition as an organization described under section 501(c)(3) should be revoked effective January 1, 20XX, because it did not operate exclusively for 501(c)(3) exempt purposes. The Organization's income inured to, and served, the private interests of its shareholder. Form 1120 US Income Tax Return should be filed for tax years ending December 31, 20XX. Subsequent returns are due no later than the 15th day of the 3rd month following the close of the Corporation's accounting period. Returns should be sent to the following mailing address:



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY

Internal Revenue Service
Tax Exempt & Government Entities
450 Golden Gate Avenue, MS 7401
San Francisco, CA 94102-3412

October 26, 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 believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

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

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

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

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

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

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

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

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination