

Internal Revenue Service
Appeals Office
1352 Marrows Road, Suite 104
Newark, DE 19711-5445

Department of the Treasury

Person to Contact:

Employee ID Number:
Tel:
Fax:

Refer Reply to:

In Re:
EO Revocation
Tax Period(s) Ended:
&

Form Number
990

Employer Identification Number
C

Date: **JUN 15 2009**

Number: **200937039**
Release Date: 9/11/2009

A

B

UIL - 0501 .32-00

CERTIFIED MAIL

Dear :

This is a final adverse determination as to your exempt status under section 501(a) of the Internal Revenue Code. It is determined that you are no longer recognized as exempt from Federal income tax as an organization described in Section 501(c)(3) of the Internal Revenue Code, effective March 17, 1999.

Our adverse determination was made for the following reason(s):

It was determined that your activities are not exclusively charitable and that assets of the organization have inured to the benefit of private individuals (i.e., your founders and/or officers) through the issuance of loans. Therefore, you are not operated exclusively for exempt purposes pursuant to section 501(c)(3) of the Internal Revenue Code. Furthermore, you have agreed to revocation of recognition of your exempt status under section 501(c)(3).

Contributions to your organization are not deductible under code section 170 of the Internal Revenue Code.

You are required to file Federal income tax returns on Form 1120 for any years that are still open under the statute of limitations.

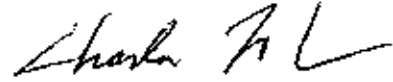
If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, formal appeals process, etc. The Taxpayer Advocate is not able to reverse legally correct tax determinations, nor extend the time fixed by law that you have to file a petition in 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. If you want Taxpayer Advocate assistance, please contact the Taxpayer

Advocate for the IRS office that issued this letter. See the enclosed Notice 1214, *Helpful Contacts for Your "Notice of Deficiency"*, for Taxpayer Advocate telephone numbers and addresses.

Thank you for your cooperation.

Sincerely,

A handwritten signature in black ink, appearing to read "Charles Fisher". The signature is fluid and cursive, with a long horizontal stroke at the end.

CHARLES FISHER
TEAM MANAGER

Enclosures:
Notice 1214



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service
30 East 7th Street, #1130-B
St. Paul, MN 55101

SFP 2 2 2008

Taxpayer Identification Number:

Form:

990

Tax Year(s) Ended:

and

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear ,

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

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

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

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

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

Letter 3618 (04-2002)
Catalog Number 34809F

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

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

Tel:

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

Marsha A. Ramirez
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

Explanation of Items

Name of Taxpayer
A

Year/Period Ended

PRIMARY ISSUE: Whether the IRC § 501(c)(3) tax exempt status of A should be revoked because it is not operated exclusively for tax exempt purposes?

FACTS:**Trust document**

A (the "Organization") was created with a Declaration of Trust (Declaration) by B and C (each being a "Founder") and B ("Trustee") on X. The Declaration provides that the Organization was created for the purpose of establishing an organization which is described in IRC § 501(c)(3) and IRC § 509(a)(3). The Declaration provides that the Founder renounces any power to determine or control, by alteration, amendment, revocation, termination or otherwise, the income or principal of the trust estate and that the Founder renounces any interest, either vested or contingent, including any reversionary interest or possibility of reverter, in the income or principal of the trust estate.

The Declaration requires that each year the Trustee shall distribute % of the adjusted net income of the Organization to D, the named Primary Charity. In addition to this distribution, each year the Trustee shall distribute a total of % of the adjusted net income to one or more organizations listed on Schedule A.

There are 108 organizations listed on Schedule A and some of them state "and affiliated organizations", such as the E and affiliated organizations, F and affiliated organizations. Some organizations listed on Schedule A are not 501(c)(3) organizations. For example, G, H, and I are among the organizations listed on Schedule A, but not found in Publication 78 listing organizations to which contributions are deductible. In addition, there is no evidence in the administrative record that establishes that the affiliated organizations are public charities.

The original Declaration provided that the Board shall be the governing body of the Organization and that the members of the Board shall be determined as follows:

- One Board member shall be appointed by the D or its designated agent
- Two Board members shall be from the class consisting of B and C and their descendants (the J Family)
- The other members of the Board shall be appointed by a majority vote of the board. The initial remaining Board members shall be K and L.

Effective X, the Declaration was amended to provide that three board members shall be appointed by D or its designated agent. Initial Board members appointed by D shall be M, K and L.

The Declaration provides that upon winding up and dissolution of the Organization, the assets shall be distributed to a non-profit fund, foundation or corporation, which is organized and

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operated exclusively for charitable, educational, religious, and/or scientific purposes and which has established its tax exempt status under section 501(c)(3).

The Declaration provides that the Trustee at his sole and complete discretion can determine the trust corpus is too small to economically administer and can distribute it to any section 170(c)(2) organization he selects.

The Declaration also states that in the event that the Organization 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 J family, as a contingent remainder.

Determination of exempt status

Based on the information provided in its exemption application, by letter dated N, 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 a supporting organization described in section 509(a)(3).

Evidence in the administrative record reveals that the Organization made at least twenty one loans to a limited liability corporation owned by its founder. Most of these loans occurred shortly after the Organization received a "contribution" of a corresponding amount. Some of these loans were made before and during the application process. The application did not contain any information regarding the Promissory Notes dated April 29, 19 : August 10, 19 or November 3, 19 . No mention of the loan made on April 29, 19 is found in the application filed in Z.

Loan	Amount	Date
#1	\$	4/29/
#2		8/10
#3	_____	11/3/
	\$	

That is to say that, although the records of the Organization show that a loan was made prior to the date of the application for exemption, and two additional loans were made before the determination was made, none of these transactions are disclosed on Form 1023, Application for Exemption.

Activities and loans

The evidence in the administrative record establishes that the Organization's founder, B made all decisions concerning its operations. The other members of the Organization's board had

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minimal, if any, involvement with the Organization. The Organization reported that it kept no minutes. B stated that a meeting is held once or twice a year and the investments and income are discussed.

The Organization made the following loans to O, a limited liability company owned by B:

Loan	Amount	date
#1		4/29/1
#2		8/10/1
#3		11/3/1
#4		2/3/1
#5		5/3/1
#6		8/1/1
#7		11/2/1
#8		2/1/1
#9		4/18/1
#10		4/19/1
#11		8/2/1
#12		10/4/1
#13		10/31/1
#14		10/23/1
#15		5/2/1
#16		1/17/1
#17		11/26/1
#18		4/22/1
#19		11/10/1
#20		12/15/1
#21		12/16/1

That is, \$ [redacted] of the Organization's funds have been distributed to its founder's limited liability company beginning in the year the Organization was created through the year of examination.

The Organization has 21 promissory notes, which are the same, except for the date and the amount. Promissory Note #16, dated January 17, 20 [redacted] spells out the words " [redacted] but uses the figure \$ [redacted], which is the amount withdrawn from the bank. Promissory Note #17 dated November 26, 20 [redacted] again spells out the words " [redacted] but uses the figure "\$ [redacted] ". The bank statements show a withdrawal of \$ [redacted] Promissory Note #15 was for \$ [redacted].

Public information on the P webpage shows that O LLC is a limited liability company. Its registered agent is B and it has no additional principals.

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In response to a request to provide information about its relationship with the borrower, A stated that the borrower, O LLC, is an LLC used for investing by B.

The following shows when contributions to the Organization were made and when promissory notes were signed.

Transfers to Organization from Q ¹ or B	Loans to O
1/15/20	1/15/20
7/25/20	
11/26/20	11/26/20
4/22/20	4/22/20
7/14/20	
8/24/20	
9/8/20	
10/13/20	
11/2/20	11/10/20
12/15/20	12/15/20
12/16/20	12/16/20

While the Organization has characterized the transactions with its founder's limited liability corporation as "loans", the evidence in the record shows that these transactions are not loans. For example, the loans lack a specific date for the repayment of principal, the transactions were not at arms' length, the Organization had an insufficient recordkeeping system to track the loans to ensure that interest payments were made and the Organization took no action to enforce the notes when interest payments were not made.

The notes are demand notes. They do not designate a term for repayment. They do say that interest at the rate of prime as stated by the R is payable at the end of December of each year. Interest for 20 of \$ was paid December 26, 20 and interest for 20 of \$ was paid January 14, 20 During the course of the examination, the Organization stated that it realized that interest on one of the notes had not been paid for a year under examination. However, it did not impose any penalty on the borrower for failure to pay the proper interest.

* * * *

¹ Q is one of B's businesses. Public information on the P webpage shows that Q is a domestic profit corporation. Its registered agent is B and it has no additional principals.

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Each note says that it is for the sole purpose of providing interest income to A. Each note also states that it is secured by real estate. The Organization stated that the loans are secured by C and B's personal residence with an unencumbered appraised value greater than loans made. Information available to the public on the webpage of S gives the 20 market value for real estate tax purposes of the residence as \$

Grants

While the Organization distributed over \$ to the limited liability company owned by its founder, the Organization appears to have provided only \$ in grants to public charities during the years under examination. The validity of some these grants are questionable because of the Organization's inadequate recordkeeping and because the Organization failed to substantiate some of the grants that it reported on its Forms 990 and it failed to substantiate that it limited its grants to the public charities that it designated on its Declaration as supported organizations.

The Organization made five grants in 20 . None were reported on the Form 990. The checks written by the Organization are not used in numerical order. This is because the Trustee stated he kept a checkbook at home and one at work.

1030	1/25/	T	\$
1031	3/3/	U	
1019	7/23/	V	
1023	12/26/	D	
1024	12/26/	F	\$

T is a 501(c)(3) organization not named in the Declaration or Schedule A.

V is not found in Publication 78, however, the A provided a letter from the Director of V dated April 5, 20 , stating that V falls under the U Office of Development and that A has not received any goods or services for its donations.

A reported two grants on its Form 990 in 20 . The Organization also made other grants in 20 .

reported on 990	U	Check 1052 made to	dated 7-20
reported on 990	W	7	No documentation provided

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Not reported on 990-check 1054	D	12/27
Not reported on 990-check 1037	F	12/27

B reported that he made a contribution to the U and the V by his personal American Express Card and A paid the American Express bill. B also stated that he did not deduct the contribution on his personal return.

Form 990 reporting

On the Form 990 filed by the Organization for the years under examination, only one person, B, is listed on Part V for officers, directors and trustees.

The Form 990 for reported the Organization's assets at year end consisted of \$ cash, \$ investments, (that were not described as required by the form and the instructions thereto) and other assets of \$ that were described as -Note Receivable-O with none of the details required by the instructions provided.²

Form 990 for also understated income for the year by \$ and failed to report any charitable grants made by the Organization. The income on the 20 return was overstated by \$

Minutes

No minutes were kept by the Organization.

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.

* * * *

² On its Form 990 for 20 the Organization checked no to the question about whether it lent money or other extension of credit to its substantial contributors ... or with any taxable organization with which any such person is affiliated as an officer ... On its Form 990 for 20 , the Organization checked yes to the question and stated "organization has loaned money to a related person. Note was executed and interest paid." The Organization reported that it had a \$ note receivable at that time - the actual loans were \$ at the end of 20 .

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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. Treas. Reg. § 1.501(a)-1(c);

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 interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

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

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

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

The very presence of a private source of loan credit may amount to inurement. Founding Church of Scientology v. United States, 412 F.2d 1197 (Ct. Cl. 1969); Church in Boston v. Commissioner, 71 T.C. 102 (1978). Loans to disqualified persons promote private rather than charitable purposes. Best Lock Corporation v. Commissioner, 31 T.C. 1217, 1235-37 (1959).

Facts that show a charity's investments that are decided in part by the needs of private interests indicate the charity may not be operated exclusively for exempt purposes. Western E v. Commissioner, 73 T.C. 196, 214 (1979). Treas. Reg. § 1.501(a)-1(c); Ginsburg v. Commissioner, 46 T.C. 47 (1966).

GOVERNMENT'S POSITION:

The IRC § 501(c)(3) tax exempt status of A (the "Organization") should be revoked because it is not operated exclusively for tax exempt charitable purposes. More than an insubstantial part of the Organization's activities served the private interests of its founder, B. Additionally, the net earnings of the Organization have inured to the benefit of an insider, B.

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As a substantial contributor, B is a disqualified person and an insider. He has operated the Organization for his own personal benefit. He stated that the checks were not used in numerical order because he keeps one checkbook at work and one at home. There is no indication that the terms of the loans to his business were considered by the entire board, that alternative investments for the Organization were considered, or that the Promissory Notes were reviewed by anyone acting in the interests of charity.

It does not appear that any attempt was made to ensure the Organization's assets were protected. The Organization made numerous transactions, characterized as "loans," where no repayment of principal was required. There is no indication that any alternative investments were considered. There is no evidence that establishes that any of the loans have been repaid. Other evidence suggests that the Foundation will never seriously demand repayment on the loans. After all, B is on both sides of the loan. He, as Trustee of the Organization and without board approval, lent almost all of the Organization's money to his business. There is no attempt by the board to ensure that the Organization receives the correct amount of interest. In addition, when the borrower failed to make the interest payments as they became due, the Organization took no action to enforce the terms of the notes.

Grants to charity by the Organization are insignificant compared to the interest-only loans made to the business interests of B.

The Organization is not attentive to the interest payments due it. Only after replying to questions raised by the examination did the Organization realize that interest on one loan had not been paid for a year under examination.

The Organization is controlled by B. He is the only person listed on the Forms 990. He writes all the checks of the Organization. He has two checkbooks for the Organization's bank account and also controls the brokerage account of the Organization.

The fact that a loan is made the same day as a contribution³ or a few days after a contribution suggests that the intent of the contribution was to make funds available for a loan.

The Organization, which is controlled by B, is operated to enable B to engage in financial activities which are beneficial to him and/or entities with whom he is transacting business, but detrimental to the Organization. Accordingly, it is operated for a substantial non-exempt purpose. See Revenue Ruling 67-5.

* * * *

³ Contribution is being used to describe the transfers made by B and/or Q to the Organization. It is not meant to imply that there was a contribution made for section 170 purposes.

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The Organization's net earnings have inured to the benefit of insiders.

An organization is described in section 501(c)(3) only if no part of its net earnings inures to the benefit of any private shareholder. The inurement prohibition is designed to insure that charitable assets are dedicated to exclusively furthering public purposes. An organization is not operated exclusively for exempt purposes if its net earnings inure to the benefit of private shareholders or individuals.

A charity's assets are required to be irrevocably dedicated to charitable purposes. Treas. Reg. § 1.501(c)(3)-1(b)(4). The inurement prohibition serves to prevent the individuals who operate the charity from siphoning off any of a charity's income or assets for personal use. By transferring the assets back to disqualified persons, purportedly as loans but as loans that do not need to be paid back until the Organization requests repayment, if ever, and/or loans that the disqualified persons do not comply with the terms of, the Organization breached the dedication requirement and its net earnings have inured to the benefit of the disqualified persons.

Although the inurement prohibition is stated in terms of net earnings, it applies to any of a charity's assets that serve the interests of its private shareholders. Harding Hospital, Inc. v. United States, 505 F.2d 1068, 1072 (6th Cir. 1974). The transfer of funds directly to the disqualified persons and to their business served the financial interests of the disqualified persons and/or their business. Facts that show a charity's investments are decided in part by the needs of private interests indicate the charity may not be operated exclusively for exempt purposes. Western E v. Commissioner, 73 T.C. 196, 214 (1979), aff'd 631 F.2d 736 (7th Cir. 1980). Even if the transaction is characterized as an investment, when a charity's investments are decided in part by the needs of private interests, the charity is not operating exclusively for exempt purposes. Western E v. Commissioner, 73 T.C. 196, 214 (1979), aff'd 631 F.2d 736 (7th Cir. 1980).

Inurement can take the form of questionable transactions that have no causal relationship to the organization's exempt purposes but result in some benefit to an insider. The insider is in a position to exercise control over the organization's net earnings as if they were his/her own by using them at will rather than within the limitations of a fiduciary capacity. In effect, the insider is using the public's "net earnings" for his/her own benefit. The facts show that B is able to use the Organization's funds as if they were his own.

The Organization's net earnings have inured to the benefit of insiders. Treas. Reg. § 1.501(a)-1(c); Ginsburg v. Commissioner, 46 T.C. 47 (1966). The very presence of a private source of loan credit may amount to inurement. Founding Church of Scientology v. United States, 412 F.2d 1197 (Ct. Cl. 1969); Church in Boston v. Commissioner, 71 T.C. 102 (1978). Loans to disqualified persons promote private rather than charitable purposes. Best Lock Corporation v. Commissioner, 31 T.C. 1217, 1235-37 (1959).

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CONCLUSION:

Accordingly, the Organization's status as an organization described under section 501(c)(3) should be revoked because it did not operate exclusively for exempt purposes because its assets inured to, and it served the private interests of, its creators.

This determination is effective X. The Organization did not inform the Service in its exemption application that it had made loans to its founders' business or the terms of the loans. The Organization transferred most of its assets to its Trustee's business as they were acquired. Therefore, the Organization failed to operate exclusively for exempt purposes when its net earnings inured to the benefit of its insiders beginning in 1999. In addition, the Organization's operations were materially different from the representations that it made in its application for exemption. Therefore, retroactive revocation is appropriate.

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

Returns should be sent to the following mailing address:

Internal Revenue Service
30 East 7th Street, #1130-B
St. Paul, MN 55101

For tax year ending December 31, 20 Form 1041 is due April 15, 20 , and should be sent to the following address:

Internal Revenue Service Center
Ogden, Utah 84201

ALTERNATIVE ISSUE: Whether A should be reclassified as a private foundation?

FACTS:

The facts concerning the organizing document and the financial activities of the Organization are described above.

There is no evidence that representatives of any of the supported organizations ever attended or participated in any meetings of the Board of the Organization, or had any input or oversight over

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the investments of the Organization. There is no evidence that any financial reportings were made to any of the supported organizations.

In 20⁰ the A made grants to the T, the U, D and the F.

In 20¹, the A made grants to the U, D and the F.

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);
- (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

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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:

(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)(1) provides guidance on the meaning of “operated, supervised, or controlled by” as follows:

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(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.

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*

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(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

(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

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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.

....

(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.

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Rev. Rul. 76-208, 1976-1 C.B. 161, held that a charitable trust described in section 501(c)(3) did not satisfy the "substantially all" requirement of the integral part test set forth in section 1.509(a)-4(j)(3)(iii)(A) of the regulations and was therefore not a supporting organization. The trust instrument provided that 75 percent of the trust income was to be distributed annually to a specified church with the remaining 25 percent to accumulate until the original corpus doubled, at which time the entire annual income was to be distributed to the church. The Service also stated that for purposes of the integral part test, the term "substantially all" means 85 percent or more.

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'S POSITION:

As set forth above, it is the government's primary position that the tax exempt status of A (the "Organization") should be revoked. Alternatively, the Organization should be reclassified as a private foundation.

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 is intentionally inclusive so that all organizations exempted from tax by IRC § 501(c)(3) are private foundations

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except for those specified in IRC § 509(a)(1) through(4). Roe Foundation Charitable Trust v. Commissioner, T.C. Memo. 1989-566; Quarrie Charitable Fund v. Commissioner, 603 F.2d 1274, 1277 (7th Cir. 1979). The Organization currently is excepted from private foundation status because it is currently classified as an organization described in section 509(a)(3), which defines supporting organizations.

Public charities (organizations described in section 501(c)(3) that meet the requirement of sections 509(a)(1) or (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, 603 F.2d at 1277-78.

To be classified as a section 509(a)(3) supporting organization, the Organization must meet all of the following tests:

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

The Organization 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 organization(s). The Organization's dissolution clause allows distributions to organizations other than the specified publicly supported organizations upon termination of the Organization. The possible beneficiaries are not limited to the D or to the organizations specified on Schedule A of the Organization's Declaration of Trust. Furthermore, the Trustee has the power to determine the trust corpus is too small to economically administer and distribute the assets to any section 170(c)(2) organization.

Therefore, the organizational test is not met. See Quarrie, supra (holding that the organizational test was not satisfied where the trustee had the power to substitute beneficiaries when, in the

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judgment of the trustee, the uses of the named beneficiaries became unnecessary, undesirable, impracticable, impossible or no longer adapted to the needs of the public).

Moreover, the operational test set forth in Treas. Reg. § 1.509(a)-4(e)(1) is not satisfied. A supporting organization will be regarded as "operated exclusively" to support a specified publicly supported organization(s) only if it engages in activities which support or benefit the specified publicly supported organizations(s). As was discussed under the Primary Issue above, the Organization has served private interests and has made loans that benefited B and his business. Therefore, it has not established that it operated exclusively for the benefit of the publicly supported organizations.

In addition, the operational test is not satisfied because the Organization made grants to organizations that were not specified in the original or the amended Declaration of Trust. These distributions are in violation of Treas. Reg. § 1.509(a)-4(e)(1). The Organization gave a grant of \$ to T in 20 This organization is not found on Schedule A of the Declaration.

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 organizing document was amended to provide that a majority of the board members would be appointed by the primary supported organization, D. A reported that M is a member of the board of A and also a member of the board of the supported organization, D. A reported that the supported organization, D, appointed M, K and L to the board of A, and also reports that K and L are clients and friends of M. Thus, the technical requirements to be a Type I supporting organization ("operated, supervised or controlled by") have been satisfied.

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Control Test

As noted above, B is a disqualified person because he is a substantial contributor to the Organization. He is the only person listed on Form 990 as an officer, director, trustee and key employee. He writes all the checks of the Organization. He has two checkbooks for the Organization's bank account and also controls the brokerage account of the Organization. Nothing shows that the board members appointed by D ever participated in any decisions made by the A board. Their names are not even reported on Form 990. There are no minutes to show that any board members participated in the Organization's investments, grants and other operations.

Additionally, there is no evidence that any of the supported organizations are attentive to the operations of the Organization. There is no indication that any alternative investments to the loans to disqualified persons were considered. There is no assurance that the Organization will attempt to enforce collection should the loans secured by the personal residence of B become delinquent. There is no attempt by the board or any of the supported organizations to ensure that the Organization receives the correct amount of interest.

The fact that a loan is made the same day as a contribution or a few days after a contribution suggests that the intent of the contribution was to made funds available for a loan. The timing of the loans suggest there was no time for loans to be considered by anyone other than B. No board member objected to almost all of the Organization's assets being transferred to B's business in a series of demand loans..

Almost all of the assets of the Organization have been transferred to B and to entities he controls. Treas. Reg. § 1.509(a)-4(j)(1) states that among the pertinent facts and circumstances to be considered are the nature of the organization's assets. When almost all of the Organization's assets are under the control of disqualified persons, that is an impermissible level of control.

In addition, the Trustee has the power to determine the Organization is too small to economically administer and distribute its assets to any section 170(c)(2) organization that he chooses. This is an impermissible level of control.

Conclusion

Accordingly, if its exempt status is not revoked, the Organization should be reclassified as a private foundation because it does not qualify as a supporting organization under the requirements set forth in Treas. Reg. § 1.509(a)-4(c) through (j).

This classification to private foundation status is effective beginning X. The Organization did not state in its exemption application that it would lend almost all of its assets to disqualified persons. It did not indicate that it would make grants to organizations other than those specified

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in its Declaration and Schedule A. It did not indicate that B would control its operations. Therefore, retroactive reclassification is applicable.

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, 20⁰¹, December 31, 20⁰² and December 31, 20⁰³. Subsequent returns are due no later than the 15th day of the 5th month following the close of the Organization's accounting period. For tax year ending December 31, 20⁰⁴ Form 990 PF is due May 15, 20⁰⁵.

Send your returns to the following mailing address:

Internal Revenue Service
30 East 7th Street, #1130-B
St. Paul, MN 55101

Note:

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