Internal Revenue Service
4920DAL: EO Mandatory Review
1100 Commerce Street
Dallas, TX 75242

Department of the Treasury

Release Number: **201032049**
Release Date: 8/13/2010

Date: April 27, 2010

Employer Identification No.:
Person to Contact:
Employee ID Number:
Tel:
Fax
Form Required to be Filed:
Tax Years:
June 30, 20XX and subsequent years
Last Day to File a Petition with the United States Tax Court:
SEE EXPLANATION BELOW

LEGEND

ORG = Organization name XX = Date

Address = address

UIL: 501.03-00

ORG

ADDRESS

Certified Mail

Dear :

This is a final adverse determination as to your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC). It is determined that you are no longer recognized as exempt from Federal income tax under IRC section 501(c)(3), effective as of the date of this letter, for the following reason(s):

> You do not qualify as an organization described in I.R.C. §501(c)(3) because you did not operate exclusively for exempt purposes within the meaning of I.R.C. §501(c)(3). You did not serve any community purpose and your net earnings inured to the benefit of your shareholders/directors/officers based on the contracts. loans and other arrangements made with the for profit organizations owned and controlled by your shareholders/directors/officers.

Contributions to your organization are not deductible under IRC section 170.

You are required to file Federal income tax returns on the form indicated above. You should file these returns within 30 days from the date of this letter, unless a request for an extension of time is granted. File the returns in accordance with their instructions, and do not send them to this office. Processing of income tax returns and assessment of any taxes due will not be delayed because you have filed a petition for declaratory judgment under IRC section 7428 or because you have filed a voluntary Chapter 7 petition under the Bankruptcy Code.

On May 9, 20XX, the organization filed a voluntary Chapter 7 petition in the United States Bankruptcy Court for the Northern District of STATE, Case No.. The issuance of a notice of revocation does not violate the automatic stay.

If you decide to contest this determination under the declaratory judgment provisions in I.R.C. §7428, the last date to file a petition with the United States Tax Court is July 26, 20XX if filing of the Tax Court petition is not prohibited by the automatic stay imposed by the Bankruptcy Code. If the automatic stay was in effect on the date of this letter or comes into effect during the period from the date of this letter through July 26, 20XX, see the description of how to calculate the last date to file a petition below

You have various options in responding to this letter.

You do not have the first option of filing a petition with the United States Tax Court because on the date that we issued the notice of revocation, the automatic stay against Tax Court proceedings is in effect and this automatic stay prohibits a person in bankruptcy from filing a petition with the Tax Court until the automatic stay is lifted or terminated by operation of law.

A second option is to request the Bankruptcy Court to lift the automatic stay under Bankruptcy Code section 362(d)(1) so that you can file a Tax Court petition while you are still in bankruptcy. If you file a Tax Court petition while the automatic stay is still in effect, the Tax Court will dismiss your petition for lack of jurisdiction.

A third option is to petition the Tax Court after the automatic stay is no longer in effect by operation of law. Generally, the automatic stay terminates by operation of law at the earliest of the time the bankruptcy case is closed, the time the bankruptcy case is dismissed, or in an individual Chapter 7 case or a case under Chapter 9, 11, 12, or 13, the time a discharge is granted or denied by the Bankruptcy Court.

WHEN TO FILE A PETITION

Second and Third Options---If the automatic stay is in effect as of the date of this letter and prohibits the filing of a Tax Court petition, you may file a Tax Court petition after the automatic stay is lifted by the Bankruptcy Court or when the automatic stay is no longer in effect by operation of law. If the automatic stay was in effect as of the date of this letter, then once the automatic stay is terminated you have 90 days from the date it was terminated (150 days if we mailed this letter to an address outside of the United States), plus the additional 60 day period set out in section 6213(f)(10 of the Internal Revenue Code to file your Tax Court petition.

Contact the clerk of the appropriate court for rules for filing petitions for declaratory judgments. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street N.W., Washington, D.C. 20217. All petitions for declaratory judgments must be filed with the Tax Court at this address. Attach a copy of this letter and copies of all statements that you receive with this letter You may represent yourself or you may be represented by anyone admitted to practice before the Tax Court.

The Tax Court cannot consider your case if the petition is filed late. The petition is considered timely filed if the U.S. postmark date falls within the 90 (or 150) day period stated above and as extended by I.R.C. §6213(f)(1), if applicable and the envelope containing the petition is properly addressed to the Tax Court with the correct postage affixed. Contacting the Internal Revenue Service (IRS) for more information, or receiving other correspondence from the IRS will not change the allowable period for filing a petition with the Tax Court. If you do not file a petition with the Tax Court within the applicable time limits discussed above, your exempt status will be revoked.

GETTING ANSWERS TO ANY QUESTIONS

If you have any questions about this letter, you may write to or call the contact person whose name, telephone number, employee identification number and IRS address are shown on the front of this letter. If you write, please include your telephone number, the best time for us to call, and a copy of this letter to help us identify your account. You may wish to keep the original letter for you records. If you prefer to call and the telephone number is outside your local calling area, there will be a long distance charge to you.

The contact person can access your tax information and help you to get answers.

Also you have the right to contact the Office of the Taxpayer Advocate. Taxpayer Advocate assistance is not s substitute for established IRS procedures such as the formal appeals process. 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 with the Tax Court. The Taxpayer Advocate can ensure that a tax matter gets prompt and proper handling when it may not have been resolved through normal channels. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued the notice of determination.

However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers. You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance or you can contact your nearest Advocate's office, in this case by calling or writing to:

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

We will notify the appropriate State officials of this action, as required by IRC section 6104(c). You should contact your state officials if you have any questions about how this determination may affect your state responsibilities and requirements.

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

Thank you for your cooperation.

Sincerely,

Doughlas H. Shulman
Commissioner

By

Nanette M. Downing
Director, EO Examinations

Enclosures:
Publication 892
Copy of this letter
cc: POA

Internal Revenue Service

Department of the Treasury
Tax Exempt and Government Entities
401 W. Peachtree St.
Room 1108, Stop 501-D
Atlanta, Georgia 30308

Taxpayer Identification Number:

Date: October 22, 2009

Form:

Tax Year(s) Ended:

ORG
ADDRESS

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,

Cheryl Cross
Internal Revenue Agent

Enclosures:
Publication 892
Publication 3498
Report of Examination

LEGEND

ORG = Organization name XX = Date Address = address City = city
State = state BM-1 & BM-2 = 1st & 2nd BM Vice President = vice president
Secretary = secretary Treasurer = treasurer RA-1, RA-2 & RA-3 = 1st, 2nd & 3rd RA CO-1 THRU CO-17 = 1ST THRU 17TH COMPANIES

ISSUE

Whether ORG, whose primary purpose and activity is selling human tissue, operates exclusively for exempt purposes within the meaning of I.R.C. §501(c)(3).

FACTS:

Based on the Form 1023, Application for Recognition of Exemption filed on August 18, 19XX, the ORG(ORG) was granted exempt status under 501(c)(3) of the Internal Revenue Code in a determination letter dated June 16, 19XX .

The Form 1023 stated that the organization's primary purpose was "to distribute musculoskeletal tissue to medical centers throughout the country for surgical transplantation. In so doing, its mission is to improve the quality of life for patients in need of musculoskeletal allographs, to assure that all tissue placed for surgery is safe and efficacious by operation in a quality environment, to provide tissue services to the medical community in an efficient, cost-effective manner, and to honor the intent of donor families by serving as a professional link in the chain of custody for their gifts until they are placed for patient use." The Form, 1023 stated that the source of the organization's financial support would be from gross receipts from providing "transplantatable tissue allographs to medical centers, physicians, dentists and other appropriate persons or facilities."

ORG was incorporated under the Non-Profit Corporation laws of the state of State on October 4, 19XX. The incorporators and officers of ORG were and are currently BM-1 and BM-2, husband and wife. Article 3.01 of the Articles of Incorporation states that the purpose of ORG is to procure process and distribute transplantable allograft materials to the medical industry.

The United States Food and Drug Administration (FDA) regulates tissue banks. Tissue banks are required by law to abide by the FDA Regulations. The American Association of Tissue Banks (AATP) also monitors tissue banking through the process of peer review. ORG had AATP accreditation for the period of December 27, 20XX through March 7, 20XX, inclusive.

The Form 990, Return of Organization Exempt From Income Tax, for the period ending June 30, 20XX, dated July 31, 20XX and received by the IRS on August 15,

20XX shows the following officers; President – BM-1, Vice-President – Vice President, Vice-President – Secretary, and Secretary/Treasurer – BM-2. The following individuals were on the of board of directors of ORG for the years 20XX, 20XX, 20XX, 20XX, and 20XX: 1) BM-1, 2) BM-2, 3) Vice President, 4) Secretary, and 5) Treasurer.

The office address of ORG is Address, City, State. Nine (9) for profit corporations shared the same office address with ORG. BM-1 and BM-2 are listed as the officers of each of the nine corporations. The nine corporations and their transactions and relationships with ORG (if known) are set forth below:

1. CO-1 (CO-1) was incorporated in the State of State on June 11, 19XX. BM-2 was the Chief Executive Officer (CEO) and secretary and BM-1 was the Chief Financial Officer (CFO). The purpose of CO-1 was to manage, purchase, and sell real property and to seek pecuniary profit by engaging in any and all business activities not prohibited by law.

On September 1. 19XX ORG and CO-1 executed a "Pre-Occupancy Agreement For Processing Facility." The agreement was signed by BM-1 as Vice President of CO-1 and by Secretary and Vice President on behalf of ORG. The agreement stated that ORG presently leased office space from CO-1 and desired to expand its operation by establishing a processing laboratory for the purpose of processing musculoskeletal allografts for human transplant. The agreement stated that CO-1 was in possession of another building at another location that would provide certain square footage of space and that ORG and CO-1 agreed to enter into a cooperative agreement that would facilitate the remodeling, build-out and relocation of the CO-1 building to Address to serve as a processing laboratory for ORG's tissue banking activities. For the stated consideration of @ ($), ORG agreed to assume expenses for all necessary interior remodeling and relocation of the building to a location rear of the parking lot at Address and that ORG would reimburse CO-1 for any expenses made on behalf of ORG for these changes. CO-1 agreed to oversee the buildingout and remodeling within the specifications submitted by ORG and to manage all negotiations with the City of City for necessary licenses and building permits. At the time of occupancy, ORG agreed to enter into a separate agreement to lease the building from CO-1. This leasing agreement was independent of the present leasing agreement between ORG and CO-1 for the upper floor space in the main building located at Address. Certain fixtures and equipment were considered the property of ORG, but CO-1 had the option to negotiate with ORG for the purchase of the equipment and fixtures within eighteen months of occupancy. The primary building structure with external attachments and other enhancements remained the property of CO-1. ORG agreed to maintain insurance on the building from the time that the agreement was executed.

On January 3, 20XX, ORG and CO-1 executed an "Agreement For Repayment of Loan." This Agreement stated that ORG and CO-1 had an agreement to acquire and renovate a modular building for the purpose of providing a certain amount of square footage for a tissue processing laboratory located at the rear of the parking lot at Address and that the building out had been completed with both CO-1 and ORG sharing expenses as set forth in a "Pre-occupancy Agreement." In this Agreement, CO-1 agreed to repayment a loan of $ advanced by ORG to CO-1 to help with the buildout. CO-1 agreed to pay ORG the amount of $ per month for a period of 52 months beginning the 15th of January, 20XX. The building and equipment was collateral for the advance until it was repaid in full by CO-1. The loan repayment Agreement was signed by BM-2, President, and BM-1, Vice President of CO-1 and by Vice President, and Secretary, Vice Presidents of ORG.

Other than the agreement to repayment, there was no other documentation of the loan provided to the Service. In response to a request for information, ORG indicated that there were other undocumented loans in amounts ranging from $ to $$ between CO-1 and ORG, between Vice President and CO-1 and Vice President and ORG.

On January 3, 20XX, CO-1 and ORG entered into a lease agreement for the tissue processing laboratory building located near the rear of the parking lot at Address. The building was used for the processing of anatomical resources for medical use. In this Agreement ORG agreed to pay rent of $$ to CO-1. The lease was for a period of 48 months with an option to renew, with certain exceptions specified in the lease. The lease Agreement was signed by BM-2, President and BM-1, as Vice-President and CO-1. The Agreement was signed by Secretary and Vice President as Vice President of ORG.

On September 1, 20XX, CO-1 and ORG entered into an "Affiliate Agency Agreement" concerning the acquisition and distribution of transplantable tissue in the distribution area listed on attachment A to the agreement. The term of the Agreement was from September 1, 20XX through August 31, 20XX, inclusive. A similar Agreement was entered for the period of September 1, 20XX through August 31, 20XX, inclusive. The later agreement was signed by BM-1 on behalf of ORG and by BM-2 on behalf of CO-1. Both Agreements stated that for the stated consideration of $. ORG and CO-1 agreed to increase the donor pool for musculoskeletal tissue and to facilitate the placement of an adequate supply of quality allograft tissue for transplantation to physicians, dentists, tissue banks, hospitals, medical centers and other appropriate medical facilities. Expenses and fees related to donor coordination, acquisition, approval and processing for distribution, as well as revenue for services rendered would be shared by ORG and CO-1 in a manner to be determined by the organizations. Attachment A to the Agreement stated that ORG paid the expenses for medical directors, shipping and

processing costs. CO-1 paid for the procurement costs invoiced by source organizations. CO-1 was to receive 50 percent of the distribution fees received for tissue placed from shared donors. The Agreement was signed by Secretary on behalf of ORG and BM-2, on behalf of CO-1.

On December 5, 20XX, CO-1 purchased an adjacent tract of land that would used for construction of an addition to the existing structure. The tract of land was purchased for $$.

On September 23, 20XX, CO-2 agreed to loan CO-1 up to ($$). The loan was secured by the property located at Address, City, State. The proceeds of the loan were used to construct a new building located at Address and to refurbish two existing buildings on the property located at Address. RA-1 and BM-2 acted as guarantors of the loan.

On December 1, 20XX CO-1 and ORG executed a lease agreeing that CO-1 would lease the entire upstairs Main Level areas and storage areas below Main Level to ORG. The term of the lease was for twenty four (24) months ending on December 1, 20XX, with ORG having the option to renew for an additional 12 to 24 months at a % increase in rent. ORG agreed to pay CO-1 rent OF $ per month during the term of the lease. The lease was signed on behalf of ORG by BM-1 and on behalf of CO-1 by BM-2, as President of CO-1.

2. CO-3 was incorporated in the State of State on September 8, 19XX. The CEO of CO-3 was BM-1 and the CFO and secretary was BM-2. The articles of incorporation stated that the purpose of CO-3 was to perform legal nurse consulting services and to seek pecuniary profit by engaging in any and all business activities not prohibited by law. CO-3 leased a portion of the premises located at Address to ORG in a lease executed on March 1, 19XX for a stated rental of $ per month. The term of the lease was for twelve months with the Lessee (ORG) having an option to renew for an additional twelve to twenty four months at a % increase in rent. This lease covered "the entire upstairs Main Level area and storage areas below Main Level." During the term of the lease, ORG was responsible for all routine maintenance, repairs, which could be deducted from the lease payment if made. ORG agreed to remove all the carpets from the floors and to refinish all the hardwood floors at its own expense. ORG agreed to apply t o the City of City for a "Façade Incentive Grant" to assist with the cost of painting the outside of the building and to replace the outside business sign. ORG agreed to match the amount provided by the City up to % of the actual costs of these improvements. The lease was signed on behalf on of the lessor by BM-2 and on behalf of ORG by Vice President, Vice President of ORG.

3. CO-4 (CO-4)– The CEO of CO-4 was BM-1. The CFO was Secretary. The

secretary was RA-2 and the agent was BM-2. CO-4's articles of incorporated stated that it had the general purpose of making pecuniary gain and profit.

On January 1, 20XX, CO-1 and CO-4 entered into a lease agreement for one office on the lower level and one joint bathroom for the property located at Address. The term of the lease was for 12 months with CO-4 having the option to renew for an additional 12 to 24 months at a % increase in rent. CO-4 agreed to pay CO-1 $ a month during the term of the lease. The Lease was signed by BM-2 on behalf of CO-1 and Secretary on behalf of CO-4.

CO-4 and ORG executed an "Affiliate Agency Agreement." The term of the CO-4 Agreement was for one year, beginning on March 1, 20XX and ending on February 28, 20XX. CO-4 agreed to represent ORG in its accounts and serve as a liaison for ORG's tissue services. The intent expressed in the contract was to increase the donor pool for musculoskeletal tissue. To pursue this intent, CO-4 agreed to establish contacts with the appropriate personnel in the hospitals that would result in the referral of donors suitable for the recovery of musculoskeletal tissue. In exchange, based on invoices, ORG agreed to pay CO-4 a service fee of % of the account amounts collected on CO-4 accounts. This Agreement was signed by . BM-1, President of ORG and Secretary, as Vice-president of CO-4

4. CO-5 was incorporated on February 1, 19XX. The corporate officers are BM-2 and BM-1. The purpose of the corporation was to perform transportation, embalming, cremations and burials for funeral homes and educational facilites.

5. CO-6 was incorporated on August 5, 20XX and the corporate officers are BM-1 and BM-2. The purpose of the corporation was to procure, distribute and process tissue or whole body donors.

6. CO-7 BM-1 and BM-2 were the corporate officers. The corporation was formed to manufacture, distribute allographs and medical products.

7. CO-8 was a temporary day care for sick children, six weeks to 13 years of age. This entity was created on March 21, 20XX.

8. CO-9 was a day care for children six weeks to 13 years of age. This corporation was created on December 10, 20XX and dissolved on March 16, 20XX.

9. CO-10 was an organization that purchased and sold hay products to farmers. The organization was created on November 13, 20XX.

ORG executed the following agreements with other entities to increase the amount of sales of tissue to physicians, dentists, tissue banks, hospitals, medical centers and

other appropriate medical facilities:

1. CO-11 located at Address, City, State – served as liaison for ORG to clients in CO-11's established sales territory. ORG agreed to pay CO-11 a service fee of % until monthly distribution level reached $$ at which time the service fee would increase to %. This Agreement was evidenced by a Letter of Intent dated January15, 19XX.

2. ORG executed an "CO-12 Agreement" with CO-12 (aka CO-12) located at Address, City, State . The term, of the agreement began on April 1, 20XX and ending on March 31, 20XX. CO-12 represented ORG and served as its liaison in the states of State and State. ORG agreed to pay CO-12 % of distribution revenue service fee as long as the $$ monthly distribution fee was maintained. The agreement was signed by BM-1, President of ORG and RA-3, President of CO-12

3. CO-13 located at Address, City, State – served as a liaison for ORG in their sales territory. ORG paid a service fee of %. In 20XX the agreement was terminated by ORG because clients furnished tissue had not paid the invoiced amounts.

4. CO-14 located at Address, City, State served as liaison for ORG. CO-14 called on and consulted with physicians known to have a need for musculoskeletal allografts provided by ORG. Service fees were paid to CO-14 on accounts for which collections had been made. Fees for specialty allografts were % of the amount collected. Fees for conventional allografts were % of the amount collected. The term of the Agreement with CO-14 was from March 1, 20XX to February 28, 20XX.

5. CO-15 (CO-15) located at Address, City, State and ORG executed a "Marketing Representative Agreement." The term of the Agreement was from May 1, 20XX through April 30, 20XX. CO-15 served as a liaison for ORG and called on medical facilities and physicians known to have a need for conventional tissue provided by ORG. Fees were % for conventional allografts and % for special allografts. CO-15 agreed to increase revenue in its service area, the state of State.

6. CO-16 (CO-16) located at Address, City, State served as a liaison for ORG and called on medical facilities and physicians known to have a need for tissue provided by ORG. The term of the Agreement was May 1, 20XX to April 30, 20XX.The fees paid by ORG were % for conventional allografts and % for special allografts. CO-16 service area was the state of State, State and State.

ORG received a letter dated June 3, 20XX from the Department of Health and Human Services. This letter was labeled "WARNING LETTER (03-ATL-21). The letter stated that during an inspection of the ORG facility conducted March 24-April 1, 20XX, the investigators documented significant deviations of the regulations for human tissue intended fro transplantation, as set forth in Title 21, Code of Federal Regulations (21

CFR) Part 1270. The investigators specifically noted the following violations: (a) failure to prepare, validate and follow written procedures for prevention of infectious disease contamination or cross-contamination by tissue during processing

During 20XX ORG was made aware by the FDA that tissue products processed and/or distributed from donors procured in the State area by CO-17 of City, State contained possibly fraudulent information in the donor documentation. ORG was one of five vendors who received the donor tissue. The tissue was procured by CO-17 without the consent of the families and proper screening for diseases. Investigation and class action lawsuits were filed against ORG. These lawsuits were one factor which caused ORG to file a Chapter 7 petition under the Bankruptcy Code. The Chapter 7 asset bankruptcy case is currently pending.

LAW:

I.R.C. §501(c)(3) provides for the exemption from federal income tax of corporations organized and operated exclusively for charitable, educational or scientific purposes, provided that no part of the net earnings inures to the benefit of any private shareholder or individual. .

Treas. Reg. §1.501(c)(3)-1(c)(1)(i) provides that an organization is organized and operated exclusively for exempt purposes only if it engages primarily in activities that accomplish the exempt purposes specified in I.R.C. § 501(c)(3).

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations defines the term "charitable" in its generally accepted legal sense to include the "advancement of education or science."

Section 1.501(c)(3)-1(d)(3) of the regulations defines the term "educational" to include "(a) [t]he instruction or training of the individual for the purpose of improving or developing his capabilities; or (b) the instruction of the public on subjects useful to the individual and beneficial to the community."

Section 1.501(c)(3)-1(d)(5)(i) of the regulations provides that a scientific organization may meet the requirements of section 501(c)(3) only if it serves a public rather than a private interest and it is organized and operated in the public interest. Section 1.501(c)(3)-1(d)(5)(ii) of the regulations provides that scientific research does not include activities of a type ordinarily carried on as an incident to commercial operations.

Treas. Reg. §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. An organization must establish that it is not organized or operated for the benefit of private interests such as designated

individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. To meet this requirement it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests.

Treas. Reg. § 1.501(c)(3)-1(e) provides that an organization that operates a trade or business as a substantial part of its activities may meet the requirements of I.R.C. § 501(c)(3) if the trade or business furthers an exempt purpose, and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business.

An organization must not engage in substantial activities that fail to further an exempt purpose. In Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279, 283 (1945), the Supreme Court held that the "presence of a single . . . [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes." In that case, the issue was whether the organization was an educational organization within the meaning of the employment tax definition set forth in 42 U.S.C. § 1011(b) which excepted from the term "employment" service performed in the employ of a charitable or education organization, no part of the net earnings of which inured to the benefit of any private shareholder or individual. This section's terms are similar to Section 501(c)(3). The organization contended that all of its purposes and activities were directed to the education of business men and the general public. Merchants were taught to conduct their business honestly and consumers were taught to avoid being victimized and to purchase goods intelligently. The Court found that the trade association had an "underlying commercial motive." In order to fall within the claimed exemption, an organization must be devoted to educational purposes exclusively. The term "exclusively" is a term of art and exclusively does not mean "solely." The term exclusively means that not more than an insubstantial part of an organization's activities are in furtherance of a non-exempt purpose. See Treas. Reg. § 1.501(c)(3)-1(c)(1) and Easter House v. United States, 12 Cl. Ct. 476, 486 (Ct. Cl. 1987), aff'd, without opinion, 846 F. 2d 78 (Fed. Cir 1988), cert. denied, 488 U.S. 907 (1988).

In Easter House v. United States, supra, the U.S. Court of Federal Claims considered whether an organization that provided prenatal care and other health-related services to pregnant women, including delivery room assistance, and placing children with adoptive parents qualified for exemption under I.R.C. §50(c)(3). The court concluded that the organization did not qualify for exemption under I.R.C.§ 501(c)(3) because its primary activity was placing children for adoption in a manner indistinguishable from that of a commercial adoption agency. The adoption service provided all of the organization's income. The court held that the business purpose and

not the advancement of educational and charitable activities purpose of the adoption service was its primary goal. The profit making fee structure of the adoption service overshadowed any other purpose.

In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the court held that an organization that operated a school to train individuals for careers as political campaign professionals, but that could not establish that it operated on a nonpartisan basis, did not exclusively serve purposes described in I.R.C. § 501(c)(3) because it also served private interests more than incidentally. The court held that private benefit and private inurement are two distinct requirements which must be independently satisfied. An organization's conferral of benefits on disinterested persons may cause it to serve "a private interest" within the meaning of Treas.Reg. §1.501(c)(3)-1(d)(1)(ii). The question of whether an organization serves private interests and whether an organization's activities are conducted for private gain may be resolved by examining the definiteness and charitable nature of the class to be benefited and the overall purpose for which the organization is operated. Size alone does not confer charitable status. See also, Quality Auditing Company, Inc. v. Commissioner, 114 T.C. 498 (20XX)(private interests include not only related persons and insiders, but also unrelated and disinterested private parties.)

In Arlie Foundation v. Commissioner, 283 F. Supp.2d. 58 (D.D.C. 20XX), organization hosted conferences and approximately 85 percent of its operating revenue was from fees paid by clients and approximately eight percent from endowments. An average of 20 percent of the conference events were for government clients, 50 percent for non-profit and/or educational clients and 30-40 percent for other users. The court considered the "commerciality" doctrine in determining whether the organization met the operational test. The commercial manner in which an organization conducts its activities may indicate that the organization is operated primarily for nonexempt commercial purposes rather than for exempt purposes. The following factors are used in applying the commerciality doctrine: (1) competition with profit commercial entities; (2) extent and degree of below cost services provided; (3) pricing policies; (4) reasonableness of financial reserve; (5) whether the organization uses commercial promotional methods (advertising); and (6) the extent to which the organization receives charitable donations. The court held that the activities of the organization were primarily for commercial and not for exempt purposes based on the following facts: the nature of organization's clients and competition, its advertising expenditures and the substantial revenues derived from weddings and special events.

In Living Faith, Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991), the court held that that an organization which ran restaurants and health food stores in furtherance of its health ministry did not qualify for tax-exempt status because it was operated for a substantial non-exempt commercial purpose, even though its activities may also further an exempt purpose (religion).

In Columbia Park & Recreation Association v. Commissioner, 88 T.C. 1 (1987), aff'd. without published opinion, 838 F.2nd 465 (4th Cir. 1988), the court held that an association formed in a private real estate development to operate parks, swimming pools, boat docks and other recreational facilities did not qualify as a I.R.C. § 501(c)(3) organization. Although the organization provided some benefit to the general public, the primary intended beneficiaries were the residents and property owners of the private development. One factor which the court considered was that the organization did not solicit or receive voluntary contributions from the public. Its source of revenue (96 percent) was from the members whom it served. The organization did not operate primarily for a public interest. The existence of a substantial nonexempt purpose, even if coexisting with an exempt purpose precludes qualification under Section 501(c)(3). In this case private benefit existed because persons having a private or personal interest (residents and property owners) in the organization's activities were the intended beneficiaries of the organization's activities.

In Church By Mail, Inc., 765 F. 2d 1387 (9th Cir. 1985), aff'g TCM 1984-349 (1984), the Court held in determining whether the organization has a substantial non-exempt purpose, , the critical inquiry is not whether particular contractual payments to a related for profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the exempt organization.. The integration between the organization's activities and those of its related for profit entities, the control of those entities by the insiders, the substantial current as well as potential abuse through manipulation of the arrangements between the entities and the large amounts of current and direct financial benefits derived from the operations of the entities by the insiders caused the court to rule that the organization was not entitled to exempt status under section 501(c)(3) of the Code.

In Est of Hawaii v Commissioner, 71 T.C. 1067 (1979), aff'd without published opinion, 647 F.2f 170 (9th Cir. 1981), the Court held an organization that was a part of a franchise system which was operated for private benefit and that the organization's affiliation with the system tainted it with a substantial commercial purpose.

In Lowry Hospital Association v. Commissioner, 66 T.C. 850, (1976), the Court held that the integration of the founder's private medical practice with the operations of the hospital, an exempt organization, resulted in the net earnings of the exempt organization inuring directly and indirectly to the founder and his family. The founders dominated the affairs of the exempt organization. The operations of the exempt organization and the founders were so integrally interwoven in their daily operation that only the faintest outlines of a separable operating charity could be perceived. There

was commingling of expenses and receipts, the sharing of employees and facilities, the joint occupancy of space and unified billing procedures. The court stated that the term "net earnings" as used in Section 501(c)(3) includes more than the net profits as reflected on the organization's books. "Net earnings" may inure to the benefit of an individual in a variety of ways, and not merely through the distribution of dividends. The court considered the fact that the organization made loans which were not in its own best interests and would not have been made by the parties on an arm-s-length basis and that these loans resulted in financial benefit to the founder of the organization and his children. The organization also made payments to improve a nursing home owned by the founder of the organization and children and therefore, they derived direct financial benefit from the organization's payment.

In Sonora Community Hospital v. Commissioner, 46 T.C. 519, (1966) , aff'd per curiam, 397 F.2d 814 ((the Cir. 1968), the Court held that the hospital had no defined plan for dispensing charity, provided only a minimal amount of charitable care, and allowed the founding doctors to share in the substantial fees from the privately operated laboratory and X-ray departments for which they performed no services of any consequence. The court held that the mere fact that the petitioner maintained a hospital did not in and of itself justify the conclusion that it was operated exclusively for charitable purposes. While the diagnosis and cure of disease are indeed purposes that may furnish the foundation for characterizing an activity as "charitable," something more is required. It was found that in this case there was no evidence that the taxpayer ever held themselves out to the public even in a limited way as a charitable institution. The charitable operation was virtually inconsequential and the hospital's operation to a considerable extent was for the benefit of the founders.

In Texas Trade School v Commissioner, 30 T.C. 642, (1958), the Court held that the net earnings of an exempt organization inured to the benefit of private shareholders when they paid excessive rentals to a dominant group of persons which managed its affairs, and made valuable improvements upon the real estate owned by such persons.

In Rev. Rul. 68-373,1968-2 C.B. 206, the Service held that an organization whose primary activity was clinically testing drugs for commercial pharmaceutical companies to comply with the Food and Drug Administration's requirements that drugs be tested for safety and efficacy before they can be marketed was not engaged in scientific research. The Ruling stated that clinical testing is an activity ordinarily carried on as an incident to a pharmaceutical company's commercial operations. The fact that the testing must be done by highly qualified professionals does not change its basic nature. The testing does not constitute scientific research within the meaning of section 1.501(c)(3)-1(d)(5)(i) of the regulations.

Rev. Rul. 72-369, 1972-2 C.B. 245 held that an organization formed to provide managerial and consulting services at cost to unrelated section 501(c)(3) organizations

was not exempt.. The services consisted of writing job descriptions and training manuals recruiting personnel, constructing organizational charts, and advising organizations on specific methods of operation. These activities were designed for the individual needs of each client organization. Receipts of the organization were from services rendered. Disbursements were for operating expenses. The Service reasoned that providing managerial and consulting services on a regular basis for a fee is trade or business ordinarily carried on for profit. The fact that the services were provided at cost and solely for exempt organizations was not sufficient to characterize the activity as charitable within the meaning of section 501(c)(3). Furnishing the services at cost lacked the donative element necessary to establish the activity as charitable.

Revenue Ruling 72-369,1972-2 C.B. 245, held not exempt under section 501(c)(3) of the Code a nonprofit organization formed to provide managerial and consulting services at cost to unrelated 501(c)(3) organizations. The organization's receipts were from services rendered and disbursements were for operating expenses. The Service reasoned that providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact that the services were provided at cost and solely for exempt organizations was not sufficient to characterize this activity as charitable under section 501(C)(3).

GOVERNMENT'S POSITION

Non-profit organizations that are "organized and operated exclusively for religious, charitable, or educational purposes" can qualify for a tax exemption under section 501(c)(3). Although the statutory provision does not specifically mention medical care, it is the position of the Service that the promotion of health is in the general law of charity deemed beneficial to the community as a whole, although it does not benefit everyone in the community. See Rev. Rul. 69-545, 1969-2 C.B. 117 and Rev. Rul. 66-323, 1966-2 C.B. 216. In Rev. Rul. 66-323, 1966-2 C.B. 216, a blood bank was held to be exempt under I.R.C. section 501(c)(3) under the facts presented. In Rev. Rul. 66-323, the blood bank, within the limits of its ability, supplied blood free for indigent and charity patients. The blood bank also served as a free repository of blood for a local research foundation in a volunteer program jointly maintained by it and the foundation. It also provided blood to other institutions for research purposes. Other activities of the organization include (a) collaborating with an exempt organization in a free program of blood typing of volunteer donors; (b) opening of several blood-drawing stations in the area which it serves; (c) pioneering in the development of a program to help meet the need for fresh blood in connection with the increasing use of open heart surgery as a standard surgical procedure; (d) allocating funds to a blood coagulation research program conducted jointly with an exempt research center; and (e) providing gratuitous services of an educational nature to the community. Although the organization charges those who are able to pay for its services, its charges for blood and blood products are generally less than the prevailing rates charged by commercial blood distributors. Furthermore, the

blood bank was committed by its charter to use all funds received for its services in excess of operating costs for the accomplishment of its declared charitable purposes, including expansion of its services as required by the community need. It was also committed to furnishing services to any person notwithstanding his/her inability to pay. Moreover, its trustees were required to review periodically the schedule of charges to insure that they are not higher than is reasonably necessary to enable it to perform its community function. In carrying out its purposes, the blood bank had a volunteer blood replacement program which enabled recipients of blood to extinguish, in whole or in part, the charges they would otherwise have to pay. With some of the institutions it serves, replacement of blood is accepted on a two-for-one basis with no service charge.

However, not every organization that promotes health will qualify for exemption under § 501(c)(3). The organization must provide some community service. In interpreting the above cited Revenue Rulings, various court decisions have highlighted several factors that are relevant under the "community benefit" analysis. These factors include:

(1) size of the class eligible to benefit;

(2) free or below-cost products or services;

(3) treatment of persons participating in governmental programs such as Medicare or Medicaid;

(4) use of surplus funds for research or educational programs; and

(5) composition of the board of trustees.

Under section 501(c)(3), a health-care provider must make its services available to all in the community *plus* provide additional community or public benefits. The benefit must either further the function of government-funded institutions or provide a service that would not likely be provided within the community but for the subsidy. Further, the additional public benefit conferred must be sufficient to give rise to a strong inference that the public benefit is the *primary purpose* for which the organization operates. See IHC Health Plans, Inc. v. Commissioner, 325 F, 3d 1199 (10th Cir. 20XX) and the cases cited therein.

In Geisinger Health plan v. Commissioner, 985 F.2d 1210(3rd. Cir, 1993), the Court held that a hospital will qualify for tax-exempt status if it primarily benefits the community. One way to qualify is to provide emergency room services, without regard to patients' ability to pay. Another way to qualify is to provide free care to indigents. A

hospital may also benefit the community by serving those who pay their bills through public programs such as Medicaid or Medicare.

ORG has failed to establish that it operated for a charitable purpose by providing community service. It merely procured tissue that was sold to medical entities that could afford to pay for the tissue. The organization did not operate any educational programs. .

The facts also indicate that the net earnings of ORG inured to the benefit of its corporate/officers/shareholders which controlled ORG and the organizations with which it entered contracts for either the leasing of the premises, improvements to the premises and sale proceeds split with the for profit entities that solicited tissue sales for ORG..

CONCLUSIONS

Accordingly, the exempt status granted ORG, Inc under Section 501(c)(3) is revoked, effective as of the date of the revocation letter.

Contributions made to ORG, Inc on or after the date of this revocation letter are not deductible by the donor under IRC 170.

ORG, Inc must file the Form 1120, U.S. Corporation Income Tax Return, for the period ending June 30, 20XX and all years thereafter, if it remains a fiscal year taxpayer or for the tax periods ending December 31st if it becomes a calendar year taxpayer.