DEPARTMENT OF THE TREASURY

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

501.03-00

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Release Number: **201035033**
Release Date: 9/3/10

LEGEND
ORG = Organization name
XX=Date Address=address

May 25, 2010
ORG
ADDRESS

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

CERTIFIED MAIL – RETURNED RECEIPTS

LAST DATE FOR FILING A PETITION
WITH THE TAX COURT: August 24, 20XX

Dear

This is a Final Adverse Determination Letter as to your exempt status under section 501(c)(3) of the Internal Revenue Code. Your exemption from Federal income tax under section 501(c)(3) of the code is hereby revoked effective July 1, 20XX.

Our adverse determination was made for the following reasons:

Organizations exempt from Federal income tax under section 501(c)(3) of the Code are required to operate exclusively for charitable, educational, or other exempt purposes. Organizations are not operated exclusively for exempt purposes if the net earnings of the organization inure in whole or in part to the benefit of private shareholders or individuals of the organization. See Treas. Reg. § 1.501(c)(3)-1(c)(2). During 20XX, 20XX, and 20XX we have determined your net earnings inured to the benefit of private individuals by regularly paying personal expenses of employees without contemporaneously recording the expenditures as salary or compensation. In addition, you paid expenses of a related for-profit owned by employees. The transactions that resulted in funds inuring to private individuals were multiple or repeated transactions during the year. As a result of your practices, the local school district took control of your organization and closed all school and other exempt activities. As such, you have not operated exclusively for exempt purposes and have operated for the benefit of the private interests of your founder in contravention of the requirements of Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii).

Also, you have been administratively dissolved by the State of STATE since 20XX and have not demonstrated you distributed your assets for exempt purposes as required by I.R.C. Section 501(c)(3) and your Articles of Organization.

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code. You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the year ending June 30, 20XX and for all years thereafter.

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

If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claim Court or the District Court of the United States for the District of Columbia before the 91st day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment.

You also have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers. You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling: (954)423-7677, or writing to:

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

We will notify the appropriate State Officials of this action, as required by section 6104(c) of the Internal Revenue Code.

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

Sincerely yours,

Nanette M. Downing
Director, EO Examinations

Internal Revenue Service
Tax Exempt and Government Entities Division
1100 Commerce Street
Dallas, Texas 75242

Department of the Treasury

Date: November 25, 2009

ORG
ADDRESS

Taxpayer Identification Number:
Form:
Tax Year(s) Ended:
Person to Contact/ID Number:
Contact Telephone Number:
Contact Fax Number:

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 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,

Sunita Lough
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination
Envelope

Form 886-A	EXPLANATION OF ITEMS	
Name of Taxpayer ORG		**Year Ended** June 30, 20XX June 30, 20XX

LEGEND
ORG = Organization name XX = Date City = city State = state
President = president VP = VP Director = director CO-1 & Co-2 = 1st & 2nd COMPANIES

Issue:

Whether ORG's tax-exempt status under section 501(c)(3) should be revoked as of July 1, 20XX.

Facts:

ORG (hereafter referred to as ORG) was granted tax-exempt status under section 501(c)(3) of the Internal Revenue Code, from the date it incorporated, Oct. 24, 20XX. ORG was formed for the purpose of operating an alternative school to give children a second chance to get an equivalent to a high school education. Initially, ORG operated a school in City, but eventually expanded and operated a second school at a City location.

ORG has been inactive since the beginning of 20XX and is not involved in any educational activities. The two alternative schools that were operated by ORG were taken over by the City County School District in the early part of 20XX. The two schools were taken over by the City County School District because of the following concerns, poor supervision, unsound business practices, and use of public money for personal gain. An audit flagged the annual $ purchase of Football season tickets and parking and the $ monthly lease of a BMW for the principal of the City Campus. There were also concerns regarding the snack facility that was operated by the CO-1.

ORG pursued court action to the State Supreme Court to try get the schools returned, but as of this time the schools still are under the control of the City County School District and the operation of the schools will not be returned to ORG.

ORG paid various expenditures that were charged on the for-profit's American Express card, the CO-1. As of today, ORG has failed to provide verification that the various expenditures were under an accountable plan and were used for business related purposes. Please refer to **Exhibit I** for a breakdown of the expenditures that are classified as not under an accountable plan. The CO-1. was controlled by the President its Director/President and by VP its Director/Vice President/ Secretary. President was also the founder of ORG and the principal of the City School, VP was the principal of the CO-2. The CO-1. is no longer operating.

ORG purchased City Football tickets to be used as rewards to the students for their achievements. When asked for an accounting of who was rewarded with the free tickets, the organization was not able to provide the information to show the tickets were used for the benefit of the students. Therefore, the ticket expenditures were not under an accountable plan.

ORG' corporation status is not current with the State of State; the organization has forfeited their corporate status with the State of State.

During a recent conversation with ORG's President, Director, he stated there was not an operating Board of Directors and that he was no longer serving as the President of ORG. He also indicated that he would not be able to provide any additional information.

Law:

Section 501(c) of the Code describes certain organizations which are exempt from income tax under section 501(a) of the Code and reads, in part, as follows:

(3)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 to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), 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 (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

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

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will not be regarded as operated exclusively for exempt purposes if more than an insubstantial part of its activities is not in furtherance of exempt purposes.

Section 1.501(c)(3)-1(d)(ii) of the regulations provides that 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, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense, and includes the promotion of education.

Private Benefit- Inurement - Law

The presence of a single substantial nonexempt purpose can destroy the exemption regardless of the number or importance of exempt purposes. Better Bus. Bureau v. United States, 326 U.S. 279. 283, 90 L. Ed. 67, 66 S. Ct. 112 (1945); Am. Campaign Acad. v. Commissioner, 92 T.C. 1053, 1065 (1989); see also Old Dominion Box Co., Inc. v. United States, 477 F2d. 340 (4th Cir. 1973), cert. denied, 413 US 910 (1973) ("operating for the benefit of private parties who are not members of a charitable class constitutes a substantial nonexempt purpose"). When an organization operates for the benefit of private interests, such as designated individuals, the creator or his family, or persons directly or indirectly controlled by such private interests, the organization by definition does not operate exclusively for exempt purposes. Am. Campaign Acad. v. Commissioner, supra at 1065-1066.

An organization will not qualify for exempt status under I.R.C. § 501(c)(3) if it is 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). Inurement refers to the non-incidental diversion of assets, which are supposed to be dedicated to charitable purposes, to an insider of the organization. See Treas. Reg. § 1.501(a)-1(c); Ginsburg v. Commissioner, 46 T.C. 47 (1966).

In People of God Community v. Commissioner, 75 T.C. 127 (1980), a newly formed Christian religious organization, which was founded by one of its ministers, paid its founder and its other ministers a predetermined percentage of the gross tithes and offerings that were received by the organization. After determining that part of the organization's net earnings inured to the benefit of private shareholders or individuals (i.e., the ministers), the Tax Court held that the organization was not exempt as an organization described in I.R.C. § 501(c)(3).

In Mabee Petroleum Corp. v. United States, 203 F. 2d 872, 875 (5th Cir. 1953), a corporation filed suit to recover overpayments of income taxes on grounds that it was entitled to charitable exemption. The United States District Court for the Northern District of Texas entered judgment against the plaintiff and the plaintiff appealed. The Court of Appeals affirmed the District Court's judgment and concluded that the District Court's finding that the salary that was paid to the founder of the charitable foundation, to which all of the founder's stock in the corporation was transferred, was excessive and constituted inurement of net earnings to the benefit of a private individual, was not clearly erroneous.

In The Founding Church of Scientology v. United States, 412 F.2d 1197, 1201 (Ct. Cl. 1969), cert. denied, 397 U.S. 1009 (1970), in addition to receiving salary, commission, and royalty payments, the founder of the church, and several members of his family, received unexplained payments in the nature of loans and reimbursements for expenditures made in plaintiff's behalf, for expenses and other purposes. The Court of Claims held that the plaintiff was not entitled to exemption from Federal income tax, because it failed to prove that no part of the corporate net earnings benefited private individuals. Thus, the plaintiff's claim was denied and the petition was dismissed.

In Parker v. Commissioner, 365 F.2d 792 (8th Cir. 1966), after the Court of Appeals concluded that the Tax Court was justified in ruling that the corporate petitioner was not entitled to tax exemption as a religious organization under I.R.C. § 501, it turned its attention to the unaccounted-for and unexplained withdrawals from the corporation's bank accounts and the checks, which were made payable to the founder, that were drawn on the organization's account. The Commissioner credited the unidentified withdrawals to the founder's income. The Tax Court sustained such action, and the Court of Appeals affirmed the Tax Court's determination, noting that [d]ue to the extremely close relationship between [the founder] and the day-to-day financial activities of [organization] and due to [the founder's] complete and unfettered control over [the organization], [the founder] has the burden of explaining unidentified withdrawals from the [organization's] accounts." Id. at 799, citing Reinecke v. Spalding, 280 U.S. 227 (1930); Arc Realty Company v. Commissioner, 295 F.2d 98 (8th Cir. 1961). "If he is unable to do so the Commissioner may validly assume that the withdrawals were income to the [founder]." Parker v. Commissioner, 365 F.2d 792, 799 (8th Cir. 1966). No evidence of any kind was produced explaining the withdrawals or indicating that the founder did not receive the benefit from them. Thus, the Court of Appeals concluded that the assessments were proper.

In Church of Scientology of California v. Commissioner, 823 F.2d 1310 (9th Cir. 1987), cert. denied, 486 U.S. 1015 (1988), the Court of Appeals affirmed the Tax Court's judgment which upheld the Commissioner's assessment of tax deficiencies and penalties against the church, following the revocation of the church's tax exempt status.
The Court of Appeal reviewed the Tax Court's factual finding that a portion of the church's net earnings inured to the benefit of L. Ron Hubbard, and his family, and OTC, a private for-profit corporation, for clear error. In finding that a portion of the church's net earnings inured to the benefit of L. Ron Hubbard, his family and OTC, the Tax Court isolated two indicia of inurement, overt and covert inurement. The overt indicia included salaries, living expenses, and royalties, and the covert indicia included "debt repayments" and L. Ron Hubbard's unfettered control over millions of dollars of church assets. The Tax Court concluded that these indicia, when viewed in light of the self-dealing associated with them, coupled with the church's failure to carry its burden of proof and to disclose the facts candidly, proved conclusively that the church was operated for the benefit of L. Ron Hubbard and his family. Id. at p. 1317. In addition to Hubbard's salary, the church paid for all of the Hubbards' living and medical expenses aboard the cruise ship Apollo. The church paid substantial royalties to L. Ron Hubbard for his books, recordings and E-meters. The record revealed that L. Ron Hubbard had unfettered control over millions of dollars in church assets, and supported the Tax Court's conclusion that L. Ron Hubbard had unfettered control over Church of Scientology Trust Fund assets. Additionally, the Tax Court found that church income incurred to the benefit of L. Ron Hubbard in a "grand scale" in the form of "debt repayments." Id. at p. 1319. In sum, the Tax Court held that "significant sums of money inured to the benefit of L. Ron Hubbard and his family" during the years at issue. The Court of Appeals found no clear error and noted that "[a]lthough neither the salaries nor the living expenses necessarily constituted evidence of inurement, the cumulative effect of Hubbard's use of the Church to promote royalty

income, Hubbard's unfettered control over millions of dollars of church assets, and his receipt of untold thousands of dollars worth of "debt repayments" strongly demonstrative inurement."

Inadequate Books and Records - Law

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

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

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

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

IRC 62 (a), which defines adjusted gross income ("AGI"), bears on the issue with respect to employees. Expenses paid or incurred by an employee in connection with the performance of services as an employee are deductible from the employee's gross income in determining AGI, but only under an expense allowance arrangement with the employer which requires the employee to substantiate the expenses and to return amounts in excess of the substantiated expenses within a reasonable period of time. (See IRC 62(a)(2) and IRC 62(c); Treasury Regulations 1.62-2 and 1.62-2(c)(2) refers to such an expense allowance arrangement as an "accountable plan." In general, if an expense allowance arrangement fails to meet any of the three requirements (business connection, substantiation, and return of the amounts in excess of expenses), then it is a "nonaccountable plan". However, if the arrangement meets the accountable rules except for the allowance of the other bona

fide expenses related to the employer's Business that are not deductible (e.g.,travel that is not away from home), then part of the expense allowance is treated as an accountable plan and part as a nonaccountable plan. (See Treasury Regulation 1.62-2(d)(2).)

Issue:

Whether ORG's tax-exempt status under section 501(c)(3) should be revoked as of July 1, 20XX.

Taxpayer's Position:

Taxpayer's has not provided their position. ORG does not have an active Board of Directors and when ORG's President, Director was contacted to discuss ORG's tax-exempt status, he indicated that he was no longer acting as the President of ORG.

Government's Position:

Section 1.501(c)(3)-1(d)(ii) of the regulations provides that 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, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Under Treas. Reg. § 1.6033-2(i)(2), every organization exempt from tax, whether or not it is required to file an annual information return, shall submit additional information as may be required by the Internal Revenue Service for the purpose of inquiring into its exempt status. During our examination we made several requests for information, but ORG failed to supply all the requested information. Except for organizations that are exempted from the annual filing requirements, I.R.C. § 6033 (a)(1) and Treasury Regulation §1.6033-2(a) provide that every organization exempt from taxation under I.R.C. § 501 (a) is required to file an annual return (Form 990), stating specifically the items of gross income, receipts, and disbursements, and shall keep such records, render under oath such statements, make such other returns and comply with such rules and regulations as the Secretary of the Treasury or his delegate may from time to time prescribe. Treasury Regulation § 1.6033-2(i)(2) provides that every organization that is exempt from tax, whether or not it is required to file an annual information return, shall submit such additional information as may be required by the Internal Revenue Service for the purpose of inquiring into its exempt status.

Various expenditures paid by ORG appear to be for the benefit of the two principals that operated the schools. ORG has not provided information to clarify that various amounts that were paid for the benefit of President, VP, or the LLC that was controlled by President and VP, were under an accountable plan and were business related expenditures. Therefore, ORG' funds were used for the private benefit of President and VP. ORG was not operating within the meaning of section

501(c)(3), since it was serving the private interests of the principals, President and VP.

ORG in no longer operating and has forfeited its exempt status with the State of State. The board of directors has dissolved and the former President, Director indicated that he does not wish to be contacted in the future. ORG is no longer active and will not be active in the future, therefore ORG is not operating within the meaning of section 501(c)(3).

Conclusion:

It is the Internal Revenues position that ORG has failed to meet the requirements for an organization described in Internal Revenue Code § 501(c)(3). ORG has failed to provide requested information to confirm that they were operated exclusively for an exempt purpose. ORG's records were incomplete and did not provide verification that various payments that were made for the benefit of President, VP, and the CO-1. were within the meaning of section 501(c)(3).

ORG is not operating and their board has dissolved, ORG has not provided information to show it was not serving the private interest of its principals, President and VP.

ORG was not operating within the meaning of section 501(c)(3), ORG does not meet the operational test under section 501(c)(3). Therefore, ORG' 501(c)(3) tax-exempt status should be revoked as of July 1, 20XX.

If you do not agree, please send your response to the following:

Internal Revenue Service