Internal Revenue Service
Appeals Office
8701 S. Gessner Dr.
Suite 750, Stop 8000 H-AL
Houston, TX 77074-2942

Date: AUG 1 0 2011

Number: **201144032**
Release Date: 11/4/2011

Department of the Treasury

Person to Contact:

Employee ID Number:
Tel:
Fax:
Refer Reply to:
In Re:
EO Revocation
Form Required to be Filed:

EIN:

Tax Period(s) Ended:

UIL: 501.03-30

Certified Mail

Dear :

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC). It is determined that you do not qualify as exempt from Federal income tax under IRC Section 501(c)(3) effective January 1, 20XX.

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

> You are not operated exclusively for exempt purposes described in section 501(c)(3). Your primary activities consisted of enhancing the marketing of dietary supplements manufactured by a for profit company. These activities were not conducted in connection with a hospital and directly or indirectly benefitted . Further, you have not demonstrated that you conducted any substantial activity for a purpose that may be described as an exempt purpose under section 501(c)(3) of the Internal Revenue Code. Thus, more than an insubstantial part of your activities is not in furtherance of an exempt purpose.

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

You are required to file Federal income tax returns on the form indicated above for tax periods beginning on and after January 1, 2006 for any open tax years. File your return with the appropriate Internal Revenue Service Center per the instructions of the return.

If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, a petition to the United States Tax Court, the United States Court of Federal Claims, or the district court of the United States for the District of Columbia must be filed within 90 days from the date this determination was mailed to you. Contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. 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.

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

You also 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 is not able to reverse legally correct tax determinations, nor extend the time fixed by law that you have to file a petition in the U.S. 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. 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.

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

Sincerely,

Karen A Skinder

APPEALS TEAM MANAGER

Enclosure: Notice 1214 Helpful Contacts for your "Notice of Deficiency"

Internal Revenue Service
Tax Exempt and Government Entities Division
1100 Commerce Street

Dallas, TX 75242

Department of the Treasury

Date:

ORG

Address
City, State

Taxpayer Identification Number:
EIN
Form:

Tax Year(s) Ended:
December 31, 20XX
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 501(c)(3) 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, Exempt Organizations, Exam

Enclosures:
Publication 892
Publication 3498
Report of Examination

ORG = Organization
20XX = Date
City = City
State = State
$ = Dollar amount
X% = Percent
# = Shares of Stock
DIR1 = Director 1
DIR2 = Director 2
DIR3 = Director 3
DIR4 = Director 4
DIR5 = Director 5
RE1 = Related Entity 1
RE2 = Related Entity 2
RO1 = Related Tax-exempt Organization 1
EMP = Related Entity 2 Employee
ATTY = Attorney
RA1 = Related Associate 1
FND1 = Org Founder 1
FND2 = Org Founder 2
FND3 = Org Founder 3
BD1 = Board Member 1
BD2 = Board Member 2
EE = Org Employee/Director
CO1 = Consultant Firm
AG = Attorney General

ISSUES

1. Whether the tax-exempt status of ORG, an organization that was granted exemption to publish and distribute books, periodicals and other information with a view toward educating the business and academic communities and the public at large about the functioning of the private enterprise free market economic system, should be revoked?

2. Whether revocation of the organization's tax-exempt status should be applied retroactively?

BRIEF EXPLANATION OF FACTS

Taxpayer was organized as ORG (ORG). ORG was granted exemption from federal income tax under section 501(a) (2) of the Internal Revenue Code on November 22, 19XX, as an organization described in section 501(c)(3). It was further determined that it was not a private foundation within the meaning of section 509(a) of the Code.

The Form 1023, Application for Recognition of Exemption, could not be obtained from either the Internal Revenue Service records or from ORG.

ORG was recognized by the State of State on July 18, 19XX. Its initial Board of Director's were FND1, FND2 and FND2. ORG was voluntary dissolved on January 2, 19XX. In November 19XX BD1, BD2 and DIR3 entered suit to have ORG reinstated. ORG was reinstated in February 19XX with the new Directors of BD1, BD2 and DIR3.

The new Directors changed ORG's activity from economic and free market system research to medical research after the reinstatement period. There is no record of the change being submitted to the Internal Revenue Service for approval or notification.

DIR1 became the medical director of ORG when it was reinstated by the State in 19XX. In 19XX, he became the medical director of RE1 (a for-profit organization), which manufactures the dietary supplements which ORG researches, until 20XX when he stepped down. The medical research conducted by ORG is almost entirely aimed at evaluating dietary supplements. Many of the dietary supplements were originally formulated by DIR1 in previous years and he and RE1 own at least one patent on the supplements. DIR1 still receives royalties from RE1 on sales of the supplements he patented and which are currently being sold by RE1. ORG is also receiving royalties from DIR1 patent rights given to ORG by DIR1. For the year 20XX DIR1 received Non-employee compensation (NEC) of $XXX,XXX from ORG, $XX,XXX from RE1 and $XX,XXX from RO1. For the year 20XX DIR1 received NEC $X,XXX from ORG and of $X,XXX,XXX from RE1. He also sold RE1 stock for over $X.X million.

When DIR1 stepped down as medical director of ORG, his wife DIR2 became its medical director. After DIR1 left RE1 employment, he began serving as medical director of RO1. The only Director/employee of ORG is EE, whose husband was one of the original directors in 19XX when the entity was re-established. EE is 83 years old and duties mainly consist of talking to people who have taken the dietary supplements and consoling them. She stated that now she works 40 hours a week, but use to work more. ORG had one other full-time employee and several part-time employees in 20XX resulting in 9 W-2's being issued in 20XX.

RE1 sells its dietary supplements through a multi-Level marketing (MLM) system. RE1 was founded by RA1 and has gross annual revenue of around $XXX million dollars.

The gross receipts for ORG for 20XX and 20XX were $XXX,XXX and $X,XXX,XXX respectively. The largest share of the funds received was from RO1 (a 501(c)(3) tax-exempt organization), as either direct donations or as research grants. The next largest source of revenues was from individuals paying for the dietary supplements they consumed as participants in the "research studies". Most of the literature sold by ORG was developed by DIR1 or his spouse or at their direction. Sells of literature in 20XX and 20XX were $XX,XXX and $XXX,XXX respectively. The literature, that ORG sells, is mainly to members of RE1. The literature acts as sales aids for members of the MLM in their sales efforts.

Total assets of ORG for the beginning and ending of 20XX were $XXX,XXX and $X,XXX,XXX respectively. Of the total assets beginning and ending balances of the Money Market Fund were $XXX,XXX and $XXX,XXX respectively. Cash on hand/bank increased from $XXX to $XXX,XXX for the year. Therefore cash or its equivalents equaled XX.X and XX.X percents of total assets at the beginning and end of the year. The Money Market Fund is maintained at UBS, which has a business relationship with DIR3, a director of ORG. This business relationship is disclosed on the filed Form 990 for 20XX.

RO1 either donates or sells dietary supplements to individuals in poor health throughout the United States and donates some of the items to orphanages worldwide. RO1 was started by RA1, who also founded RE1. Most of RO1 funding is from RE1, or members of RE1 or others related to RE1. RO1 paid ORG to conduct research on the dietary supplements that it either sold or donated. The research is administered and directed by DIR1 who is paid a substantial fee by ORG for his services. In prior years, DIR1 has received stock grants in RE1 valued in the millions of dollars.

Substantial fees have been paid over the years to RE2. RE2 is owned by DIR3. DIR3 was one of the individuals in 19XX that had ORG reinstated and became one its directors. EMP, an employee of RE2 along with DIR3 were both directors of ORG in 20XX. EMP was also paid a salary of $X,XXX besides the amounts paid from RE2. During 20XX, RE2 was paid $XX,XXX for advisory and accounting fees, which consisted of a monthly retainer of $X,XXX ($X,XXX for accounting plus $X,XXX for advisory services) plus an additional payment of $XX,XXX (designated as for additional advisory services). During the same period, ORG paid EE, a director and officer $XX,XXX. Her deceased husband BD2 was also one of the original individuals who had ORG reinstated in 19XX. DIR2 (wife of DIR1) Medical Director of ORG received only $X,XXX for her services. DIR1 received $XXX,XXX as Research Administrator.

Directors in 20XX were DIR3, EMP, DIR4, EE and DIR5. EE was the only officer and director in 20XX. All of the directors, except for EE, resigned effective March 1, 20XX and were replaced by DIR1 and DIR2. When asked about the change, DIR4 stated that they (the old directors) did not have the expertise needed to guide ORG in the research that it was doing.

ORG used an article called "Summary Report – 20XX Review of Physicians Recruitment Incentives" as its basis for fees paid to DIR1. The report was not prepared for ORG and the analysis had nothing to do with a doctor conducting research.

RE2 prepared an engagement letter for accounting, management and financial advisory services it rendered to ORG. The copy inspected was only signed by DIR3 for RE2 and had spaces for EE, DIR4 and DIR5 to sign as Directors but was blank. The engagement letter was not dated and listed Accounting Service Fee as $X,XXX per month, with an estimated 35-50 hours per month for the time to be applied. Monthly retainer for the management and financial advisory services was $X,XXX, with an estimated time requirement of 40-50 hours. Attached to the letter was a sheet dated November 20, 20XX that listed RE2 fee structure for Management and Financial Advisory Services, Accounting Services and CFO Services. They did not provide time sheets or any other documentation indicating times actually spend on services provided; although requested on two Information Document Request. They did provide an opinion letter from another accountant that the fees proposed by RE2 were reasonable.

ATTY, a lawyer in City, State who specializes in non-profit-related matters and, stated "It is highly inappropriate for a charity engaged in scientific research to conduct research substantially for one company.

In July 20XX, the State Attorney General filed a civil complaint related to regulatory compliance and sales practices that predominantly took place from 20XX to 20XX. Parties to the suit were RE1, RO1, ORG, RA1, Individually and DIR1, Individually. The action was brought by Attorney General AG, through his Consumer Protection and Public Health Division, upon the grounds that Defendants have engaged in false, misleading, or deceptive acts or practices in the course of trade and commerce.

Excerpts from the complaint are presented below:

Paragraph 7 Defendant DIR1 was formerly the "Medical Director" of Defendant RE1, and currently holds a similar position with Defendant RO1. On information and belief, Defendant DIR1 also generally controls the operations of Defendant ORG.

Paragraph 12 Defendants market and sell dietary supplements....and try to distance themselves from responsibility for these illegal disease claims for their dietary supplements in numerous ways, including: substituting the word "glyconutrients" for the name of RE1's products; setting up alternate websites; claiming that third parties who they have not control over are making the illegal claims in books, videos, and other marketing materials; using testimonials to make claims that Defendants' products, cure, mitigate, treat or prevent diseases; and employing the façade of a disciplinary policy for associates making illegal disease claims, all the while enabling the system under the claims made.

Paragraph 17 B Defendants further endorse the making of a disease claim to cure, treat or mitigate Down syndrome for their products through a book offered at their conventions titled, , which includes a forward by Defendant DIR1, who at the time was written, was the Medical Director of RE1.

Paragraph 36 Defendant ORG, ...In fact, upon information and belief, Defendant ORG serves no legitimate charitable purpose, but instead is run and controlled by Defendant DIR1 and his wife DIR2 for the benefit of RE1 and its associates. As a result, Defendant ORG is little more than a sham charity with the sole purpose of providing "scientific" support to the illegal health claims made about RE1's products. Virtually all of the Defendant ORG's revenue comes from selling publications to RE1 associates.

Final Judgment and Agreed Permanent Injunction Against RA1 was entered on February 26, 20XX. RA1 could no longer operate in any way with RE1 except as a consultant for five years. Cease any false advertising including all types of media. That he (including assigns, servants, agents, employees, etc) is prohibited from any capacity in RO1. Shall pay a penalty of $X,XXX,XXX to the State of State.

Final Judgment and Agreed Permanent Injunction Against RE1 was entered on February 26, 20XX. In the judgment RE1 could not have anyone that was both an officer of RE1 and RO1. They could not use RO1 in any deceptive or misleading manner in connection with the promotion of RE1's products.

There has not been a settlement between The ORG Institute or DIR1 with the State as of June 16, 20XX.

LAW and Analysis

Issue 1.

Section 501(c)(3) of the Code exempts from federal income tax organizations organized and operated exclusively for charitable, educational, and other exempt purposes, provided that no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

The definition of net earnings for exempt organizations has change from a purely mechanical computation and dissemination of net earnings, and embraces a much wider range of transactions and other activities.

Code Section 170(b)(1)(A)(iii) defines deductions limitations for contributions to medical research organizations and as such defines that if a organization is a medical research organization it must be directly engaged in the continuous active and the conduct of medical research in conjunction with a hospital.

Regs. Section 1.170A-9(c)(2) further amplifies that even though an organization need not receive contributions deductible under section 170 to qualify a medical research organization, however, the requirement that a medical research organization does not qualify as a exempt organization unless it is associated with a hospital is maintained.

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.

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.

In Christian Stewardship Assistance vs. Commission, 70 T.C. 1037, an organization was formed as a nonprofit corporation to support and assist religious, educational and/or other nonprofit organizations in their relationships with their contributors and in stimulating proper application of Christian stewardship principles among their contributors. To reimburse its cost of operation, petitioners charge a fee to each subscribing organization. Court determined that the described activities, although helpful to charitable organizations are not exclusively for charitable purposes, but rather serve private interest by advising individuals about methods to decrease Federal income and estate taxes.

TAXPAYER'S POSITION

Taxpayer does not believe that any amounts paid were excessive and/or provided private benefit. They cite a study that was conducted by CO1 in November 20XX that stated that RE2 was in fact under paid for the listed services. They go into detail about the fact that ORG hires RE2 to act as its CEO and list eleven functions that they perform in that capacity.

They further state their position that ORG's purpose is to facilitate scientific research and education and will foster health and wellness. They granted $XX,XXX to unrelated entities such as the Cancer Treatment Research Foundation for a study related to prostate cancer, the Clemson University Foundation for its work related to nutria-genomics, the University of Missouri for a Lubahan Prostate Cancer Study, and the University of Texas Southwestern to aid in its work with nutritionals.

GOVERNMENT'S POSITION

Although tax-exempt charitable organizations may provide benefits to persons in their private capacity, benefits of this nature must, to avoid jeopardizing exempt status, be incidental both quantitatively and qualitatively in relation to the furthering of exempt purposes. To be quantitatively incidental, the private benefit must be insubstantial, measured in the context of the overall tax-exempt benefit conferred by the activity. The instant case spends more than half of the EO resources benefiting disqualified persons and constitutes both Private Benefit and Inurement which are prohibited.

ORG changed its stated purpose from the purpose for which it was granted exemption. It has changed from a free market advocate to medical research facility. The medical research does not qualify for exemption since it is not related to a hospital as required by the regulations.

In addition, it is apparent that ORG and its officers and directors have gone to some length to disguise the inurement to its officers. ORG conducts "research" on products developed by its former medical director and the spouse of its current medical director. Those fees have been paid by related entities of RO1 and RE1. RE1, along with DIR1, benefited both directly and indirectly as beneficiaries of the "research" conducted by ORG. The research for 20XX and all prior years was on dietary supplements manufactured by RE1. DIR1 received substantial fees from ORG and stock in RE1. In the year 20XX DIR1 received compensation of $X,XXX,XXX from RE1 and sold stock in the company for over $X.X million dollars. Per Form 4, filed with the SEC, DIR1 purchased from RA1, Chairman and CEO of RE1 # shares of RE1 on 12/22/20XX at a price of $X.XX a share. The stock price of RE1 on 12/22/20XX ranged from a low of $XX.XX to $XX.XX per share. At the low price DIR1 received a discount of $X,XXX,XXX from the stocks Fair Market Value.

The research conducted is for determining the effects of the dietary supplements on individuals' health that consumed the supplements which were either purchased or donated. Many of the participants in the study pay for the supplements directly to ORG while some received the supplements free or were paid for by donations made by MLM members of RE1.

DIR3 received substantial fees through RE2 for accounting and advisory services. These fees in 20XX were $XX,XXX or X% of total revenue for ORG. They also amounted to almost XX% of total revenue of RE2. ORG revenue was total gross receipts of $X,XXX,XXX include bond redemption of $XXX,XXX leaving receipts of $X,XXX,XXX with $XXX,XXX or XX% from activities related to RE1 and RO1. DIR1 was paid $XXX,XXX to manage the research for ORG and his wife was Medical Director. The major asset of ORG was cash and bonds (average amounted to XX.X% of total assets) that were maintained in a money market account at UBS Financial Services in which DIR5 (a director) was a securities broker.

As noted above, an organization that operates for the benefit of private interests, such as designated individuals, by definition does not operate exclusively for exempt purposes. ORG does not qualify for exemption.

CONCLUSION

Based on the foregoing reasons, the organization does not qualify for exemption under section 501(c)(3) and its tax exempt status should be revoked.

Issue 2.

IRC § 7805(b) provides that the Secretary may prescribe the extent, if any, to which any ruling (including any judicial decision or any administrative determination other than by regulation) relating to the internal revenue laws shall be applied without retroactive effect.

Rev. Proc. 98-1, 1998-1 I.R.B. 7 provides that except in rare or unusual circumstances, the revocation or modification of a letter ruling will not be applied retroactively to the taxpayer for whom the letter ruling was issued or to a taxpayer whose tax liability was directly involved in the letter ruling provided that: (1) there has been no misstatement or omission of material facts; (2) the facts at the time of the transaction are not materially different from the facts on which the letter ruling was based; (3) there has been no change in the applicable law; (4) the letter ruling was originally issued for a proposed transaction; and (5) the taxpayer directly involved in the letter ruling acted in good faith in relying on the letter ruling, and revoking or modifying the letter ruling retroactively would be to the taxpayer's detriment.

TAXPAYER'S POSITION

The organization does not agree that it should be revoked and that if it is revoked that it should not be retroactively applied. The organization believes it does not fall within Rev. Proc. 2008-1, allowing retroactive revocation.

GOVERNMENT'S POSITION

Section 7805(b) relief should not be granted in this case, since the organization, contrary to its position, does not meet the listed five criteria; the organization failed to conduct the tax-exempt activities that it reflected in its application for exemption. When the organization realized that it would not nor could not operate as authorized and therefore, changed its exempt purpose, it did not notify the Service of this change as required by regulations. Accordingly, the failure to disclose the information is an omission of a material fact and the organization's tax-exempt status should be revoked retroactively.

CONCLUSION

Based on the foregoing, the organization is not entitled to section 7805(b) relief and consequently revocation of exempt status should be effective as of the first day of the 20XX tax year.