



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
TEGE EO Examinations Mail Stop 4920 DAL  
1100 Commerce St.  
Dallas, Texas 75242

Date: January 12, 2018

Release Number: 201830022

Release Date: 7/27/2018

UIL Code: 501.03-00

Tax Year Ending:  
December 31, 20XX, 20XX, 20XX, 20XX, 20XX  
Taxpayer Identification Number:

Person to Contact:

Employee Identification Number:

Employee Telephone Number:  
(Phone)  
(Fax)

**CERTIFIED MAIL – RETURN RECEIPT**

Dear \_\_\_\_\_ :

This is a final determination that you do not qualify for exemption from Federal income tax under Internal Revenue Code (the "Code") section 501(a) as an organization described in Code section 501(c)(3) effective January 1, 20XX. Your determination letter dated October 5, 20XX is revoked.

The revocation of your exempt status was made for the following reason(s):

Organizations described in section 501(c)(3) of the Internal Revenue Code and exempt from tax under section 501(a) must be both organized and operated exclusively for exempt purposes. You have failed to establish that you are operated exclusively for exempt purposes and that no part of your net earnings inure to the benefit of private shareholders or individuals.

The transferors/donors of business and property interest, including limited partnerships and limited liability companies, to you handled their business and property interests in substantially the same way both before and after the purported transfers/donations to you.

Also, little or no actual economic benefits were transferred to you as a result of the purported transfers/donations.

Contributions to your organization are no longer deductible under IRC §170 after January 1, 20XX.

Organizations that are not exempt under section 501 generally are required to file federal income tax returns and pay tax, where applicable. For further instructions, forms, and information, please visit [www.irs.gov](http://www.irs.gov).

If you decide to contest this determination, you may file an action for declaratory judgment under the provisions of section 7428 of the Code in one of the following three venues: 1) United States Tax Court, 2) the United States Court of Federal Claims, or 3) the United States District Court for the District of Columbia. A petition or complaint in one of these three courts must be filed within 90 days from the date this determination letter was mailed to you. Please contact the clerk of the appropriate court for rules and the appropriate forms for filing petitions for declaratory judgment by referring to the enclosed Publication 892. You may write to the courts at the following addresses:

United States Tax Court  
400 Second Street, N.W.  
Washington, D.C. 20217

U.S. Court of Federal Claims  
717 Madison Place, N.W.  
Washington, D.C. 20439

U.S. District Court for the District of Columbia  
333 Constitution Ave., N.W.  
Washington, D.C. 20001

Processing of income tax returns and assessments of any taxes due will not be delayed if you file a petition for declaratory judgment under section 7428 of the Internal Revenue Code.

The Taxpayer Advocate Service (TAS) is an independent organization within the IRS that can help protect your taxpayer rights. TAS can offer you help if your tax problem is causing a hardship, or you've tried but haven't been able to resolve your problem with the IRS. If you qualify for TAS assistance, which is always free, TAS will do everything possible to help you. Visit [www.taxpayeradvocate.irs.gov](http://www.taxpayeradvocate.irs.gov) or call 1-877-777-4778.

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

Sincerely,

Maria Hooke  
Director, EO Examinations

Enclosure:  
Publication 892



**Department of the Treasury  
Internal Revenue Service  
Tax Exempt and Government Entities  
Exempt Organizations Examinations**

Date: April 17, 2017

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:  
20XX- 20XX

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Manager's Name/ID Number:

Manager's Contact Number:

Response due date:  
May 17, 2017

**Certified Mail – Return Receipt Requested**

Dear :

**Why you are receiving this letter**

We propose to revoke your status as an organization described in section 501(c)(3) of the Internal Revenue Code (Code). Enclosed is our report of examination explaining the proposed action.

**What you need to do if you agree**

If you agree with our proposal, please sign the enclosed Form 6018, *Consent to Proposed Action – Section 7428*, and return it to the contact person at the address listed above (unless you have already provided us a signed Form 6018). We'll issue a final revocation letter determining that you aren't an organization described in section 501(c)(3).

After we issue the final revocation letter, we'll announce that your organization is no longer eligible for contributions deductible under section 170 of the Code.

**If we don't hear from you**

If you don't respond to this proposal within 30 calendar days from the date of this letter, we'll issue a final revocation letter. Failing to respond to this proposal will adversely impact your legal standing to seek a declaratory judgment because you failed to exhaust your administrative remedies.

**Effect of revocation status**

If you receive a final revocation letter, you'll be required to file federal income tax returns for the tax year(s) shown above as well as for subsequent tax years.

**What you need to do if you disagree with the proposed revocation**

If you disagree with our proposed revocation, you may request a meeting or telephone conference with the supervisor of the IRS contact identified in the heading of this letter. You also may file a protest with the IRS Appeals office by submitting a written request to the contact person at the address listed above within 30 calendar days from the date of this letter. The Appeals office is independent of the Exempt Organizations division and resolves most disputes informally.

For your protest to be valid, it must contain certain specific information including a statement of the facts, the applicable law, and arguments in support of your position. For specific information needed for a valid protest, please refer to page one of the enclosed Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*, and page six of the enclosed Publication 3498, *The Examination Process*. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process. Please note that Fast Track Mediation referred to in Publication 3498 generally doesn't apply after we issue this letter.

You also may request that we refer this matter for technical advice as explained in Publication 892. Please contact the individual identified on the first page of this letter if you are considering requesting technical advice. If we issue a determination letter to you based on a technical advice memorandum issued by the Exempt Organizations Rulings and Agreements office, no further IRS administrative appeal will be available to you.

**Contacting the Taxpayer Advocate Office is a taxpayer right**

You have the right to contact the office of the Taxpayer Advocate. Their assistance isn't a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate can't reverse a legally correct tax determination or extend the time you have (fixed by law) to file a petition in a United States court. They can, however, see that a tax matter that hasn't 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:

Internal Revenue Service  
Office of the Taxpayer Advocate

**For additional information**

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,

Mary A. Epps  
Director, EO Examinations

Enclosures:  
Report of Examination  
Form 6018  
Publication 892  
Publication 3498



Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer	-Tax Identification Number	DECEMBER 31, 20XX- 20XX

### Form 1023

Forms 990 for 20XX thru 20XX year were examined. In statements provided during the examination, stated that:

( ) primary goal is to support charitable organizations exclusively both locally and nationally. Funds are raised through distributions from LPs and LLCs wherein has been gifted an interest. markets its services through financial planners who implement charitable giving plans for their clients. They refer their clients to \_ as their designated charity in most situations. has as a program where certain donors can direct their gifts to their favorite charities or charitable causes. All directed gifts are required to be distributed to organizations who qualify under one or more of the exempt categories. only material expense is the marketing/fundraising fees paid to financial advisors who refer donors to .

### 20XX Form 990

In its 20XX Form 990, the organization reported \$0 as total contributions (\$0 – came from a related entity- ), and investment income of \$0. Total assets shown on the balance sheet was \$0 as of 12/31/20XX. It reported a total of \$0 in grants.

The Forms 990 for 20XX- 20XX were not complete. The Form 990 for 20XX omitted Part IV (List of Officers, Directors, Trustees). The return was signed by without indicating his title in the organization. Part V, line 38a was answered incorrectly. stated that he made a loan of \$0 to the organization. The minutes of the organization and State of records reflect and his wife as the officers and Board members of the organization. They have been listed on the Form 990 as officers from 20XX- 20XX. was listed as Vice President on the 20XX and 20XX returns. has stated several times that he was not

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involved in the day to day operations of the organization. Agent interviewed on April 22, 20XX and he stated that he just signs the checks as directed by and he hasn't been involved with the organization for the last 5-6 years other than that. Agent also noted that signed all of the returns except for 20XX (signed by ), 20XX (signed by but name was typed in, and 20XX return that was signed by

is an attorney, a certified public accountant, and a certified valuation analyst. He earns his revenue from high-wealth clients to which he assists in forming and administering various partnerships and LLCs established to accomplish charitable giving. He also provides valuation services. He serves as the organization's accountant, bookkeeper, tax return preparer, legal advisor, spokesman, and POA. The Board of Directors minutes provided by the organization indicated that he was not an officer of the organization during the examination years.

has organized several tax-exempt entities including ; ( )\*; ( ); ( ); (is a one- member LLC under ) and -(For Profit). These have been used as the organizations to which many of his clients ultimately donate portions of their LLC interest to (i.e. Interest of 0%). The LLC entities then distribute funds to the tax-exempt company and it then sends checks to various other charities (such as churches after charging an administration/management fee). When the clients gift a portion of the created LLC's, a charitable deduction is created. He receives income for his professional services and the related tax exempt entities serve as the charitable gifting avenue.

is involved in the majority of the transactions required to set up the limited partnership "arrangements" for his clients. is involved in the day-to-day operations of , the recipient of the gifts of limited partnership interests.

With respect to the limited partnership "arrangements", prepares the majority of the required legal documents. prepares the limited partnership agreements (including documents related to issuance of General and Limited Partnership Units), the limited liability company operating agreements (including documents related to the issuance of Managing and Non-Managing Member Units), the appraisals of the limited partnership interests and non-managing member interests, the required Secretary of State filings, as well as the preparation of the Federal Forms 1065 and Schedules K-1. also prepares the documents related to the contribution of the limited partnership interests to the exempt organizations; these documents include



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the "Assignment of Limited Partnership Units", the "Assignment of Non-Managing member Units", the "Consent to Assignment of the Limited Partnership Interest", and the "Consent to the Assignment of the Non-Managing Member Units".

With respect to                      established the exempt organization and continues his involvement in all aspects of day-to-day operations (                      is a maintenance worker for the                      school system, and                      is a school teacher) for the exempt organization.                      prepared and filed the Forms 1023 application with the Internal Revenue Service for approval to create and operate the exempt organization..                      prepares and files all required state documents with Secretary of State.                      prepares and files the annual Federal Forms 990 for the exempt organization.

The limited partnership interests and the non-managing member interests transferred to                      are not "transferable partnership interests." According to the limited partnership agreement, a limited partner may transfer their limited partnership interest if certain conditions are satisfied. One of the conditions requires the unanimous written consent of all the partners. This condition would require not only the exempt organizations' agreement to the sale but would also require the agreement of all partners. According to the limited liability company, operating agreement certain requirements must be met to transfer a membership interest. One of the requirements is the unanimous approval of all members. This condition would not only require the exempt organizations' agreement to the sale but would require the agreement of all members.

                    is involved in the majority of the transactions required to set up the limited partnership "arrangements" for his clients.                      is involved in the day-to-day operations of                      ,                      , and                      , the recipients of the gifts of limited partnership interests.

With respect to the limited partnership "arrangements",                      prepares the majority of the required legal documents.                      prepares the limited partnership agreements (including documents related to issuance of General and Limited Partnership Units), the limited liability company operating agreements (including documents related to the issuance of Managing and Non-Managing Member Units), the appraisals of the limited partnership interests and non-managing member interests, the required Secretary of State filings, as well as the preparation of the Federal Forms 1065 and Schedules K-1.                      also prepares the documents related to the contribution of the limited partnership interests to the exempt organizations; these documents include the "Assignment of Limited Partnership Units", the "Assignment of Non-Managing member Units", the "Consent to Assignment of the Limited Partnership Interest", and the "Consent to the Assignment of the Non-Managing Member Units".

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With respect to established the exempt organizations and continues his involvement in all aspects of day-to-day operations for the exempt organization. prepared and filed the Forms 1023 application with the Internal Revenue Service for approval to create and operate the exempt organizations. prepares and files all required state documents with Secretary of State. prepares and files the annual Federal Forms 990 for the exempt organizations.

The limited partnership interests and the non-managing member interests transferred to are not "transferable partnership interests." According to the limited partnership agreement, a limited partner may transfer their limited partnership interest if certain conditions are satisfied. One of the conditions requires the unanimous written consent of all the partners. This condition would require not only the exempt organizations' agreement to the sale but would also require the agreement of all partners. According to the limited liability company, operating agreement certain requirements must be met to transfer a membership interest. One of the requirements is the unanimous approval of all members. This condition would not only require the exempt organizations' agreement to the sale but would require the agreement of all members.

prepared and signed the 20XX and 20XX Form 990 returns. It should be noted that on the 20XX Form 990, name was typed on the return. The required signature was actually signature.

### Board Meetings

The only board meeting held was the annual meeting where officers were appointed. No other issues were documented and no other actions were authorized. The minutes for the meeting held on January 14, 20XX indicated that "over the last 0 years there has been several audits of current donors to ." "All of these audits were approved and validated and were given No Changes by the IRS". "The President stated that the IRS may decide to audit the organization in an effort to revoke the exempt organization's tax status" "The President stated that the opinion of counsel from tax attorneys including, tax litigators is that should at no point voluntarily allow the IRS to revoke its exempt status based on No Change audits of donors who gifted LLC units to the organization. Also the overwhelming weight of legal authority which does not prohibit from acceptance of LLC units where the LLC agreement is approved and the manager of the LLC is required to comply with the fiduciary duty which ensures that the LLC interest owned by is protected."

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### Board of Directors

The organization stated (correspondence letter 10/8/20XX) that from 20XX- 20XX, the directors were not related. and his wife have been the directors of from 20XX to present. works full time for County school corporation. (Revenue Agent confirmed this and that he is employed as a custodian) during his interview of on 4/29/20XX. is currently attending college and works for a local bank. (Agent did not confirm this statement).

stated in the interview that he has not been active with the organization for over 0 years. The filed Form 990 indicates the following: 20XX- - Pres,  
- VP, 20XX- - VP, - Pres, 20XX- - Pres,  
- VP, 20XX- - Pres, - VP, 20XX- -  
President

### Activities

The organization stated that their activities support local and nationwide charities as part of its mission. The Directors ( and ) choose the charitable organizations to support for 20XX- 20XX. They could not explain how they selected the organizations to fund nor could they explain how they became aware of the organizations they were funding. (Especially organizations located out of state). They stated that there were no loans made prior to 20XX. The organization contracts with professional fundraisers to help raise funds for the organization. The fundraiser is paid a percentage of the "gift" amount received. These fees are only paid after the "gift" has been received by the organization. An examination of the organization's financial and operational records indicates that the organization had substantial "donors" who reside outside of . The primary "fundraisers" live and work in . It was noted that these fundraisers did not receive a Form 1099 for the clients they provided.

During the examination years, created the following transactions:

1. On August 30, 20XX, was formed by and he paid \$0 for 0 member units.
2. On August 31, 20XX, he transferred units to (an entity he created) for \$0 consideration (gifted).
3. On October 12, 20XX, "gifts" Intellectual Property (IP) stated to be: Customer lists, Contacts lists, Trade Secrets, Systems and Processes, Client Agreements, Appraisal Systems and Accounting Processes to (who became an officer of in 20XX) for \$0 consideration. He appraised this IP at \$0. These are the same services he performs in his private business and reports on his individual tax return. He explained to his business associates (financial planners and contacts) that payments from new clients (Nov 20XX and forward) requesting

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formation and administering services for their charitable gifting arrangements are to now be made payable to \_\_\_\_\_, LLC.

4. On October 13, 20XX, \_\_\_\_\_ transferred the IP to \_\_\_\_\_
5. On October 15, 20XX, \_\_\_\_\_ was created. \_\_\_\_\_ was issued 0% of the membership interest (0 units)
6. On October 20, 20XX, \_\_\_\_\_ transferred the \_\_\_\_\_ in exchange for 0 LLC units of \_\_\_\_\_. ( \_\_\_\_\_ formed \_\_\_\_\_ on August 20, 20XX and he paid \$0 for 0 member units. On August 31, 20XX, transferred \_\_\_\_\_ units to \_\_\_\_\_ for \$0 consideration.)
7. On October 23, 20XX, \_\_\_\_\_ transferred the 0 units in to \_\_\_\_\_ for \$0 consideration. (This was not reported on Form 990)
8. On October 25, 20XX, \_\_\_\_\_ and \_\_\_\_\_ entered into a Trade Secret and Intellectual Property Licensing Agreement whereby \_\_\_\_\_ pays 0% of its gross revenues to \_\_\_\_\_ for the use of the IP.
9. On April 30, 20XX, \_\_\_\_\_ transferred his 0% interest in \_\_\_\_\_ to \_\_\_\_\_ for \$0 consideration
10. \_\_\_\_\_ prepares all of the related entities tax returns.
11. On January 1, 20XX, \_\_\_\_\_ ( \_\_\_\_\_ ) assigned any and all interest of any kind currently owned in Limited Partnerships or LLCs to \_\_\_\_\_, a 501(c)(3) public charity.
12. On February 11, 20XX, \_\_\_\_\_ filed Certificate of Dissolution with the Secretary of State Office. (Voluntarily Dissolved- 1/1/20XX, Adoption date- 1/1/20XX and effective date- 2-11-20XX)
13. On February 11, 20XX, \_\_\_\_\_ created \_\_\_\_\_ -a For-Profit Domestic Corporation

### Promotion of Partnership

The examination of the financial and operational records presented showed that main activity was the promotion of a program where a donor creates an entity, a LLC entity, with a 0% non-voting interest owned by the donor, and a 0% voting interest owned by donor. The donor contributes the 0% non-voting interest or 0% to creating a partnership or disregarded entity. Through the agreement creating a partnership entity, the general partner retains full control of the partnership entity. The non-voting interest cannot be sold, transferred, or substituted without the general partner's permission. The general partner can admit new non-voting interest members diluting ownership and the general partner can dispose of assets at will and on any terms and controls any distributions. In some partnership agreements, the non-voting interest assigns a power of attorney to the general partner. The donor then donates the non-voting interest to \_\_\_\_\_ while retaining the ownership of the general partner. The

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donor never relinquishes control of the underlying assets. There were 0, 0, 0, 0, and 0 partnerships returns (Form 1065) filed respectively for 20XX, 20XX, 20XX, 20XX, and 20XX.

The Partnership/LLC/LP agreement that has with its donors does not allow to have any control of the assets of the partnership. The General Partner (Donor) has complete control of the assets. He can sell, trade, or use the assets for nonexempt purposes without consent of . only receives the income generated from the assets as reported on the Form 1065's and K-1's. It was also noted that several identified financial planners had setup LLC/LP with and therefore created a relationship that will identify them also as an insider.

charges a fee to set up and maintain the partnerships and to appraise the non-voting interest donated to . He charges an additional annual fee based on the asset value. Appraisals are for around 0% to 0% of the book value even though the appraisal states that non-voting interest is not transferable and has no control. The LLC and partnership interests accepted by that were reviewed included very few prepared by independent contractors. The majority was prepared by and all that the agent reviewed were appraised by . Fees for the preparation and appraisals were deposited to the account but it was not possible to determine if the funds were part of funds or private practice. The agreements do not allow sales or distributions and the appraisals note that the donated 0% limited interests are completely controlled by the general partner. Donations are exclusively non-voting interests in partnerships and LLC's, a small amount of cash distributions and fees. Investments are the maintained partnership and LLC agreements and residual income.

#### Income from the partnerships in 20XX- 20XX

After donation receives K-1 Forms for the allotted share (usually 0%) of income from the partnership. The general partner receives 0% of the income. treats the income as passive income excluded from UBIT.

During the years 20XX- 20XX, failed to report on its Form 990, all income from Schedule K-1's. The Schedule K-1's arise from limited partnership interests resulting from non-cash contributions. The donors claim a charitable deduction for the amounts reported as contributions on Form 990. The donors are the general partners that retain control over the assets held by the partnerships. The income reported on the Schedule K-1's issued to should be reported on its Form 990. The organization also had income from disregarded entities. Agent was not able to determine the exact amounts due to the fact that these entities are not required to

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file income tax returns and the organization did not maintain records to identify the sources of revenue and the related expenses.

In a past examination (20XX- 20XX), IRS successfully revoked the tax exempt status of a related entity also created and operated by . That entity was also created and operated in the exact same manner as . agreed to the decision to revoke the entity's exempt status and stated in his response (dated 12/20/20XX) he would agree to our proposed revocation of tax exempt status as of 1/1/20XX if we would offer a closing agreement identical to the one the Service entered with him on a related entity that was revoked on the same issues. This would be an obvious way to settle the case.

### Law:

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

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that in order for an organization to be exempt under section 501(c)(3) of the Code it must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational or operational test, it is not exempt

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that an organization operates exclusively for exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in § 501(c)(3). An organization must not engage in substantial activities that fail to further an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals

Section 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.

Section 1.501(c)(3)-1(d)(2) defines the term "charitable" for § 501(c)(3) purposes as including the relief of the poor and distressed or of the underprivileged, and the promotion of social welfare by organizations designed to lessen neighborhood tensions,

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to eliminate prejudice and discrimination, or to combat community deterioration. The term "charitable" also includes the advancement of education. "

Section 1.501(c)(3)-1(d)(3)(i) provides, in part, that the term "educational" for § 501(c)(3) purposes relates to the instruction of the public on subjects useful to the individual and beneficial to the community.

Section 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 § 501(c)(3) if the trade or business furthers an exempt purpose, and if the organization's primary purpose does not consist of carrying on an unrelated trade or business

In *Better Business Bureau v. United States*, 326 U.S. 279 (1945), the Supreme Court stated that the presence of a single nonexempt purpose, if substantial in nature, will preclude exemption under section 501(c)(3) of the Code, regardless of the number or importance of statutorily exempt purposes. Thus, the operational test standard prohibiting a substantial nonexempt purpose is broad enough to include inurement, private benefit, and operations that further nonprofit goals outside the scope of section 501(c)(3).

Rev. Rul. 68-489, 1968-2 C.B. 210, holds that an organization will not jeopardize its exemption under section 501(c)(3) of the Code, even though it distributes funds to nonexempt organizations, provided it retains control and discretion over use of the funds for section 501(c)(3) purposes. The revenue ruling states that the exempt organization ensures use of the funds for section 501(c)(3) purposes by limiting distributions to specific projects that are in furtherance of its own exempt purposes. It retains control and discretion as to the use of the funds and maintains records establishing that the funds were used for section 501(c)(3) purposes.

In *Best Lock Corporation v. Commissioner*, 31 T.C. 620 (1959), the court upheld the denial of an organization that loaned funds to members of the founder's family, even though the loans were repaid. The court determined that loans to family members and unsecured loans to friends of the founder and his family promoted private rather than charitable purposes.

IRC § 6001 provides that every person liable for any tax imposed by the IRC, or for the collection thereof, shall keep adequate records as the Secretary of the Treasury or his delegate may from time to time prescribe.

IRC § 6033(a)(1) provides, except as provided in IRC § 6033(a)(2), every organization exempt from tax under section 501(a) shall file an annual return, stating specifically the items of gross income, receipts and disbursements, and such other information for the

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purposes of carrying out the internal revenue laws as the Secretary may by forms or regulations prescribe, and keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Secretary may from time to time prescribe.

Treas. Reg. § 1.6001-1(a) in conjunction with Treas. Reg. § 1.6001-1(c) provides that every organization exempt from tax under IRC § 501(a) and subject to the tax imposed by IRC § 511 on its unrelated business income must keep such permanent books or accounts or records, including inventories, as are sufficient to establish the amount of gross income, deduction, credits, or other matters required to be shown by such person in any return of such tax. Such organization shall also keep such books and records as are required to substantiate the information required by IRC § 6033.

Treas. Reg. § 1.6001-1(e) 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.

Treas. Reg. § 1.6033-1(h)(2) 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 IRC § 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 IRC § 6033 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 IRC §§ 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.



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### Benefiting Private Interests

Even if an organization's activities serve a charitable class or are otherwise charitable within the meaning of § 501(c)(3), it must demonstrate that its activities serve a public rather than a private interest within the meaning of Reg. § 1.501(c)(3)-1(d)(1).

Rev. Rul. 72-147, 1972-1 C.B. 147, held that an organization that provided housing to low income families did not qualify for exemption under § 501(c)(3) because it gave preference to employees of business operated by the individual who also controlled the organization. The ruling reasoned that, although providing housing for low-income families furthers charitable purposes, doing so in a manner that gives preference to employees of the founder's business primarily serves the private interest of the founder rather than a public interest.

In *KJ's Fund Raisers v. Commissioner*, T.C. Memo 1997-424 (1997), aff'd, 1998 U.S. App. LEXIS 27982 (2d Cir. 1998), the Tax Court held, and the Second Circuit affirmed, that an organization formed to raise funds for distribution to charitable causes did not qualify for exemption under § 501(c)(3) because its activities resulted in a substantial private benefit to its founders. The founders of the organization were the sole owners of KJ's Place, a lounge at which alcoholic beverages were served. The founders served as officers of the organization and, at times, also controlled the organization's board. The Tax Court found, and the Second Circuit agreed, that the founders exercised substantial influence over the affairs of the organization. The organization's business consisted of selling "Lucky 7" or similar instant win lottery tickets to patrons of KJ's Place. The organization derived most of its funds from its lottery ticket sales. The organization solicited no public donations. The lottery tickets were sold during regular business hours by the owners of the lounge and their employees. From the proceeds of the sales of the lottery tickets, the organization made grants to a variety of charitable organizations. Although supporting charitable organizations may be a charitable activity, the Tax Court nevertheless upheld the Commissioner's denial of exemption to the organization on the ground that the organization's operation resulted in more than incidental private benefit. The Tax Court held, and the Second Circuit affirmed, that a substantial purpose of KJ's activities was to benefit KJ's place and its owners by attracting new patrons, by way of lottery ticket sales, to KJ's Place, and by discouraging existing customers from abandoning KJ's Place in favor of other lounges where such tickets were available. Thus, the organization was not operated exclusively for exempt purposes within the meaning of § 501(c)(3).

An organization does not serve a public rather than a private interest within the meaning of Reg. 1.501(c)(3)-1(d)(1) if any of its assets or earnings inure to the benefit of any insiders (or disqualified persons). Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii).

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A number of courts have held that unaccounted for diversions of a charitable organization's resources by one who has complete and unfettered control can constitute inurement. *Parker v. Commissioner*, 365 F.2d 792, 799 (8th Cir. 1966); *Kenner v. Commissioner*, 318 F.2d 632 (7th Cir. 1963); *Church of Scientology*, 823 F.2d at 1316-17, 1319.

The provision of inurement can be direct or indirect. In *Church of Scientology*, 823 F.2d at 1315, the organization transferred in excess of \$3.5 million to a for-profit corporation incorporated by the organization's founder and his wife. The directors of the corporation were high-ranking members of the Church of Scientology. The directors approved the founder's decision to transfer \$2 million from the corporation's account to the ship *Apollo* aboard which the founder and his family lived. The Ninth Circuit held that the funds funneled through the for-profit corporation constituted inurement to the founder and his family. *Church of Scientology*, 823 F.2d at 1318.

In *Church by Mail, Inc. v. Commissioner*, 765 F.2d 1387 (9th Cir. 1985), the Ninth Circuit held that a church that conducted its activities by mail did not qualify for exemption under § 501(c)(3) because a substantial purpose of its activities was to benefit a for-profit corporation controlled by the church's insiders. The church employed an advertising agency controlled by its insiders to provide all of the printing and mailing services for the church's mass mailings. The advertising agency devoted approximately two-thirds of its time to the work for the church. The majority of the church's income was paid to the advertising agency. Although the advertising agency claimed to have clients unrelated to the church, it did not advertise its services and refused to identify its other clients. The Ninth Circuit held that the church was operated for the substantial non exempt purpose of "providing a market for [the advertising agency's] services" and, thus, primarily served the private interests of the advertising agency and its owners rather than a public purpose. In so holding the Ninth Circuit rejected the church's argument that the income paid by the advertising agency should not be included in the determination of reasonableness and treated this income as indirect inurement of the church's earnings to the church's insiders.

The prohibition on inurement in § 501(c)(3) is absolute. The Service has the authority to revoke an organization's exempt status for inurement regardless of the amount of inurement. See, *Spokane Motorcycle Club*, *supra*; *The Founding Church of Scientology*, 412 F.2d at 1202.

#### **Government's Position:**

does not qualify as an organization described in IRC 501(c)(3) because (1) it is not operated for an exclusive exempt purpose; (2) it

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substantially benefits private interests and (3) its net earnings inure to the benefit of private shareholders and individuals.

Not operated for an exclusive exempt purpose

does not engage in any charitable activities. The organization stated on its Form 1023, that it will not make grants, loans or other distributions to organizations. During 20XX- 20XX, the organization made distributions to various organizations and individuals. The organization did not provide any documentation to support the claim that monies are awarded based on need. The organization did not have any specific guidelines and procedures to determine whether an individual qualified (as a charitable class) for a charitable or educational grant. There was no independent group of individuals who were charged the task of making the grant selections. The organization did not exercise due diligence in determining that the monies that the grants were being used for the intended exempt purpose. When agent interviewed the President ( ) and about the award procedures, they stated that there were no specific procedures, they would send checks to whomever told them. Therefore, the grants awarded do not qualify as an exempt function expense and is considered to be a private benefit to the individuals who received the funds.

main activity in 20XX- 20XX was the promotion of partnerships and disregarded entities with donors. In 20XX, received the assets of (a related 501( c)(3) entity) as a result of their voluntary termination with the State of . These assets were the same type of assets (LLCs, partnerships, disregarded entities) that the organization is reporting on their Form 990. The donors were never informed of the transfer by the organization. continues to operate a program that (1) allows individuals, partnerships, limited partnerships, and LLC's to claim a section 170 deduction for asset(s) donated to , but allows the donor to retain control and subsequently purchase the asset(s) back at a value that is substantially less than the charitable amount initially claimed. These transactions do not exclusively serve an exempt purpose described in section 501(c)(3) and provides substantial private benefit to persons who do not belong to a charitable class (including the organization's founder)

It is the Service's position that the donor does have advisory and/or control of monies/assets contributed only by him (not over the entire general fund and segregated as the organization seems to be stating) and even though the organization claims there's no segregated fund recorded, the facts are that the funds are identified when donated and checks were issued to the donor's named charity. These transactions are structured to give the appearance that they are donor advised funds when in fact, the organization has not provided any information to support the position that they control

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the distributions of the monies, and they did not perform their due diligence in making sure that the funds were being used for exempt purposes. This will allow the shifting of income from taxable entities to a tax exempt organization for the purpose of deferring or avoiding taxes. These transactions have the same economic effect as the transaction described in Notice 2004-30, IRB 2004-17, April 26, 2004.

The Partnership/LLC/LP agreement that has with its donors does not allow to have any control of the assets of the partnership. The General Partner (Donor) has complete control of the assets. He can sell, trade, or use the assets for nonexempt purposes without consent of . only receives the income generated from the assets as reported on the Form 1065's and K-1's. It was also noted that several identified financial planners had setup LLC/LP with and therefore created a relationship that will identify them also as insiders.

It is our position that the partnership activities, which were the main activities of , had a substantial non-exempt purpose. In addition, the partnership activities provided a private benefit to the donors.

#### Inurement

The gifting of IP to and was subsequently transferred to , is considered to be inurement because he received a financial benefit in the form of a 170 deduction When he never gave up control of the IP. The IP licensing Agreement between and calling for a 0% fee for the use of the IP is considered to be inurement because had complete control of when "gifted" him his ownership and it was acknowledged by the parties that the services offers could only be performed by (promoting and\_ developing charitable gift plans for high wealth individuals. This entails creating LLC's, LLP's, Trusts, filing organization papers, valuating client's properties, working with other financial planners, preparing tax and information returns. has no other employees. acknowledges he did all of the work and was the brains behind the business, without him, there would be no business. He directed the financial planners and other contacts to "write my fee to . stated that this income is reported on tax return, which is consolidated with Form 990, and therefore wouldn't show up as taxable income.

#### Taxpayer's position:

In a past examination (20XX- 20XX), IRS successfully revoked the tax exempt status of a related entity also created and operated by

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that was created and operated in the exact same manner as .  
agreed to the decision and stated in his response (dated 12/20/20XX) to our  
IDR request that the revocation of the tax exempt status of would be an  
obvious way to settle the case.

**Conclusion:**

It is the IRS's position that failed the operational test as described in Income Tax Regulations 1.501(c)(3)-1 (d)(i) and 1.501(c)(3)-1(d)(ii). was not operated exclusively for an exempt purpose. It serves private rather than public interests. Its net earnings inured to the benefit of private shareholders and individuals. The Service agreed to enter into a Closing Agreement whereby the organization's exempt status will be revoked, effective January 1, 20XX and the remaining assets shall be returned to the donors. The organization agreed and signed the Form 906.