

**Internal Revenue Service**  
Appeals Office  
312 Elm Street, Suite 2330  
Cincinnati, OH 45202-2763

Number: **201036030**  
Release Date: 9/10/2010

Date: June 16, 2010

\*\*\*\*\*  
\*\*\*\*\*

**Department of the Treasury**

**Person to Contact:**  
\*\*\*\*\*

**Employee ID Number:** \*\*\*\*\*

Tel: \*\*\*\*\*

Fax: \*\*\*\*\*

**Refer Reply to:**  
AP:FE:OH:CIN:\*\*\*\*\*

**In Re:**  
EO Revocation  
**Form Required to be Filed:**  
1120

**EIN:**  
\*\*\*\*\*

**Tax Period(s) Ended:**  
12/2006 12/2007  
**UIL: 501.33-00**

**Certified Mail**

Dear :

This is a final adverse determination regarding your exempt status under Internal Revenue Code (IRC) section 501(c)(3). It is determined that you do not qualify as exempt from Federal income tax under IRC section 501(c)(3) effective January 1, 2006.

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

A substantial amount of your organization's assets inured to the private benefit of your founder. Because a substantial amount of your charitable assets were used for private purposes, the organization is not operated exclusively for exempt purposes described in section 501(c)(3) of the Code.

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

You are required to file Forms 1120, U.S. Corporation Income Tax Return, for tax periods beginning on and after October 1, 2003 with the Cincinnati Service Center, Cincinnati, OH, 45999-0012.

You have waived your right to contest this determination under the declaratory judgment provisions of Section 7428 of the Code by your execution of Form 906, Closing Agreement Concerning Specific Matters, an executed copy of which is being sent to you under separate cover.

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,

\*\*\*\*\*

APPEALS TEAM MANAGER

Enclosure:

Notice 1214 Helpful Contacts for your "Notice of Deficiency"



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

**DEPARTMENT OF THE TREASURY**

Internal Revenue Service  
550 Main Street, Room 6417  
Cincinnati, OH 45202-3222

ORG  
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

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

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

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

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

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

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

Letter 3618 (04-2002)  
Catalog Number 34809F

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

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

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

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer		Year/Period Ended
ORG		December 31, 20XX December 31, 20XX

**LEGEND**

ORG = Organization name      XX = Date      State = state      President = president  
CO-1 & CO-2 = 1<sup>st</sup> & 2<sup>nd</sup> Companies

**ISSUES:**

Whether ORG meets the operational requirements under Section 501(c)(3), since a significant amount of revenues inured to the benefit of an officer and it was only incidentally engaged in charitable undertakings.

**FACTS:**

ORG, (hereinafter referred to as ORG), is an entity that was incorporated as a non-profit corporation in the State of State on May 18, 19XX. ORG is a subsidiary organization, to CO-1 – CO-1, under Group Ruling Number 8298, granted exemption under Internal Revenue Code Section 501(c)(3) on July 1, 19 .

The amended Articles of Incorporation, dated March 5, 20XX, identify President as the President of ORG. The articles further provide the purposes of the corporation are as follows:

- To provide support and assistance to the educational systems through tutoring centers and tutoring programs.
- To financially assist, accredited, non-profit schools in an effort to maintain quality educational facilities, equipment and special needs.
- To provide charitable services and financial aid to other community 501(c)(3) organizations.

Analysis of the bank statements and canceled checks, account number, revealed the following:

	20XX	%	20XX	%
<u>Gross Receipts</u>				
<u>Disbursements</u>				
Wages and Form 1099(MISC) Income	\$	%	\$	%
Health & Life Insurance	\$	%	\$	%
Distributions	\$	%	\$	%
Other	\$	%	\$	%
Payments to President	\$	%	\$	%
Sprint	\$	%	\$	%

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer		Year/Period Ended
ORG		December 31, 20XX December 31, 20XX

See Exhibit #1 – Spreadsheet of Disbursements and Deposits

The review of the books and records also revealed only an incidental amount of gross receipts were expended for charitable purposes. Substantial disbursements were made to CO-2, which is a 501(c)(19) organization. No evidence was provided that these funds were subsequently used for charitable purposes. Only a minimal amount of grants were made to 501(c)(3) organizations. No other charitable activities were conducted by ORG.

	20XX	%	20XX	%
CO-2	\$	%	\$	%
Distributed for charitable purposes	\$	%	\$	%

Payments made to President, were identified as overtime, and reimbursement for automobile, utility, accounting, supplies, office, and miscellaneous expenses. ORG had no accountable plan in place for expense reimbursement. Additional payments for services were not reported as, Compensation of Officers, on line 25 of Form 990 and were not included in wages reported on Forms 941.

**LAW:**

Section 501(c)(3) of the Internal Revenue Code (IRC) exempts from federal income tax organizations that are both organized and operated exclusively for one or more of the exempt purposes specified in section 501(c)(3). An organization that fails to meet either the organizational or the operational test is not exempt. *Treas. Reg. § 1.501(c)(3)-1(a)(1).*

For IRC § 501(c)(3), exempt purposes include religious, charitable, scientific, testing for public safety, literary, educational, and prevention of cruelty to children or animals. *Treas. Reg. § 1.501(c)(3)-1(d)(1).*

The term "charitable" is used in section 501(c)(3) in its generally accepted legal sense, and should not be limited by the separate enumeration in section 501(c)(3). The term includes relief of the poor or underprivileged, advancement of religion, advancement of education or science, lessening of the burdens of government, promotion of social welfare, lessening neighborhood tensions, and combating community deterioration. *Treas. Reg. § 1.501(c)(3)-1(d)(2).*

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer		Year/Period Ended December 31, 20XX December 31, 20XX
ORG		

**Organizational test** – The organizational test is met through an organization’s articles of organization, which includes the corporate charter, trust instrument, or any other written document by which an organization is created. *Treas. Reg. § 1.501(c)(3)-1(b)(2)*.

An organization is organized exclusively for one or more exempt purposes only if its articles of organization limit the purposes of the organization to exempt purposes and do not expressly empower the organization to engage, except in an insubstantial manner, in activities that do not further its exempt purposes.

In meeting the organizational test, the organization’s purposes, as stated in its articles of organization, may be as broad as, or more specific than, the purposes stated in IRC § 501(c)(3). If the articles state that the organization is formed for “charitable purposes”, such articles ordinarily shall be sufficient for purposes of the organizational test. *Treas. Reg. § 1.501(c)(3)-1(b)(1)(ii)*.

**Operational test** – An organization meets the operational test only if it engages primarily in activities which accomplish one or more of the exempt purposes specified in IRC § 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not furtherance of an exempt purpose. *Treas. Reg. § 1.501(c)(3)-1(c)(1)*.

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. *Treas. Reg. § 1.501(c)(3)-1(c)(2)*.

An organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than private interest. To meet this requirement, an organization must establish “that it is not organized or operated for the benefit of private interest such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests”.

The existence of a substantial nonexempt purpose regardless of the number or importance of exempt purposes will cause failure of the operational test. *Better Business Bureau v. U.S., 326 U.S. 279 (1945)*

Section 61 of the Internal Revenue Code (IRC) provides that gross income means all income from whatever source derived, including compensation for services, fees, commissions, fringe benefits, and similar items.

IRC section 62(a)(2)(A) and section 1.62-2(b) of the Income Tax Regulations provide that, for purposes of determining adjusted gross income, an employee may deduct certain business expenses paid by the employee in connection with the performance of

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer		Year/Period Ended
ORG		December 31, 20XX December 31, 20XX

services as an employee under a reimbursement or other expense allowance arrangement with his employer.

IRC section 62(c) provides that, for purposes of section 62(a)(2)(A), an arrangement will be treated as a reimbursement or other expense allowance arrangement if (1) the arrangement requires the employee to substantiate the expenses to the payor, and (2) the arrangement requires the employee to return to the payor any amount in excess of the substantiated expenses.

Thus, a reimbursement or other expense allowance arrangement satisfies the requirements of section 62(c) only if it meets the requirements of business connection, substantiation, and returning amounts in excess of substantiated expenses. If an arrangement meets these requirements, all amounts paid under the arrangement are treated as paid under an accountable plan. Treas. Reg. §1.62-2(c)(2)(i). Amounts treated as paid under an accountable plan are excluded from the employee's gross income, are not required to be reported on the employee's Form W-2, and are exempt from the withholding and payment of income and employment taxes. Treas. Reg. §1.62-2(c)(4).

If an arrangement does not satisfy these requirements, all amounts paid under the arrangement are treated as paid under a "nonaccountable plan." Treas. Reg. §1.62-2(c)(3). Amounts treated as paid under a nonaccountable plan are included in the employee's gross income, must be reported as wages or other compensation of the employee's on Form W-2, and are subject to withholding and payment of income and employment taxes. Treas. Reg. §1.62-2(c)(5).

**TAXPAYER'S POSITION:**

President, President of ORG, stated he believed distributions made to CO-2, were charitable. He reimbursed himself for what he felt was appropriate for vehicles, contract labor, utilities, office, professional fundraising, supplies, postage, shipping, occupancy, printing, and travel. Receipts for items such as postage, shipping, travel, printing, supplies, etc., were not kept. The amount of reimbursement was only an average and or estimate from past years of operation.

**GOVERNMENT'S POSITION:**

ORG was not engaged primarily in activities that accomplish an exempt purpose. Only four percent of gross receipts were distributed for charitable purposes. Part of ORG's activities was making distributions to CO-2, a 501(c)(19) organization, which serves private benefit rather than public interests. A substantial part of the net earnings of ORG inured to the benefit of President, a disqualified person with respect to ORG.



Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer  ORG		Year/Period Ended December 31, 20XX December 31, 20XX

**CONCLUSION:**

ORG is not a charitable organization exempt from tax under I.R.C. § 501(c)(3) for the taxable years of 20XX and 20XX. Net earnings inured to the benefit of the president of the organization. We are revoking its exempt status effective January 1, 20XX. This organization is required to file Forms 1120 for all tax periods beginning after December 31, 20XX