



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

501.03-00

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Date: August 4, 2010

Release Number 201045030  
Release Date: 11/12/10  
LEGEND  
ORG = Organization name  
XX = Date Address = address

Taxpayer Identification Number:  
Person to Contact:  
Employee Identification Number:  
Employee Telephone Number:  
Phone)  
(Fax)

ORG  
ADDRESS

LAST DATE TO FILE A PETITION

IN TAX COURT: November 2, 20XX

CERTIFIED MAIL – RETURN RECEIPT

Dear

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (the Code). Our favorable determination letter to you dated January 2, 20XX is hereby revoked and you are no longer exempt under section 501(a) of the Code effective January 1, 20XX.

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

Organizations described in IRC 501(c)(3) and exempt under section 501(a) must be both organized and operated exclusively for exempt purposes. You have failed to produce documents to establish that you are operated exclusively for exempt purposes and that no part of your net earnings inures to the benefit of private shareholders or individuals. You failed to respond to repeated reasonable requests to allow the Internal Revenue Service to examine your records regarding your receipts, expenditures, or activities as required by sections 6001 and 6033(a)(1) of the Code and Rev. Rul. 59-95, 1959-1 C.B. 627.

Since no documentation was provided to show the checks issued by you were issued for charitable purposes, we would conclude that, in fact, the checks were issued for the benefit of the Trustee, resulting in inurement.

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

You are required to file income tax returns on Form 1041. These returns should be filed with the appropriate Service Center for the tax year ending December 31, 20XX, and for all tax years thereafter in accordance with the instructions of the return.

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 Internal Revenue Code.

If you decide to contest this determination under the declaratory judgment provisions of section 7428 of the Code, a petition to the United States Tax Court, the United States Claims Court, or the district court of the United States for the District of Columbia must be filed before the 91<sup>st</sup> Day after the date this determination was mailed to you. Please contact the clerk of the appropriate court for rules regarding filing petitions for declaratory judgments by referring to the enclosed Publication 892. You may write to the United States Tax Court at the following address:

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 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 contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Nanette M. Downing  
Director, EO Examinations

Enclosures:  
Publication 892



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY

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

November 30, 2009

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.

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 Internal Revenue Code.

If you decide to contest this determination under the declaratory judgment provisions of section 7428 of the Code, a petition to the United States Tax Court, the United States Claims Court, or the district court of the United States for the District of Columbia must be filed before the 91<sup>st</sup> Day after the date this determination was mailed to you. Please contact the clerk of the appropriate court for rules regarding filing petitions for declaratory judgments by referring to the enclosed Publication 892. You may write to the United States Tax Court at the following address:

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Sincerely,

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

**LEGEND**

ORG = Organization name      XX = Date      Address = address      City = city  
State = state      CEO = CEO      DIR-1 = 1<sup>st</sup> DIR      CO-1, CO-2, CO-3, CO-4,  
CO-5 & CO-6 = 1<sup>st</sup>, 2<sup>nd</sup>, 3<sup>rd</sup>, 4<sup>th</sup>, 5<sup>th</sup> & 6<sup>th</sup> COMPANIES

**ISSUES:**

1. Whether ORG operated exclusively for exempt purposes as described within IRC section 501(c)(3):
  - a. Whether ORG should continue to qualify for exemption since it has refused to file Form 990-PF for tax years ending December 31, 20XX, 20XX, and 20XX.
  - b. Whether ORG engaged primarily in activities which accomplish an exempt purpose?
  - c. Whether more than an insubstantial part of ORG's activities were in furtherance of non-exempt purposes?
  - d. Whether any part of ORG's net earnings inured to the benefit of any private shareholder or individual, including CEO
  - e. Whether ORG failed to keep adequate books and records or other documentation as required under section 6001 and 6033.

**FACTS:**

Background

An examination of ORG was conducted by the Secretary's representative for the taxable periods ending December 31, 20XX, 20XX and 20XX respectively.

ORG was established pursuant to the Trust Agreement between CEO, Founder and CEO and DIR-1 as the Trustees, on July 13, 20XX.

Article II of the Trust Agreement states ORG is created exclusively for charitable, religious, scientific, literary, and educational purposes, including, for such purposes, the making of distributions to organizations that qualify as exempt organizations under section 501(c)(3) of the Internal Revenue Code.

Article IV of the Trust Agreement states in part (a) The principal and income of all property received and accepted by the Trustees to be administered under the Trust Agreement shall be held in trust by them, and the Trustees may make payments or distributions from income or principal, or both, to or for the benefit of such one or more organizations that qualify as exempt organizations under section 501(c)(3)...  
(c) No part of the net earnings of ORG shall inure or be payable to or for the benefit of any private individual....

ORG was recognized as exempt from federal income tax, on January 2, 20XX, under section 501(a) of the Code by reason of being described in section 501(c)(3) of the Code and further described as a private foundation as defined in section 509(a) of the Code.

The application for exemption, Form 1023, included a statement in Part II, Activities and Operational Information as follows: The ORG will make grants to other 501(c)(3) organizations classified as public charities for religious, educational, scientific, and literary purposes. The ORG will develop operating procedures to assure that it adheres to the rules of IRC sections 4941, 4942, 4943, 4944, and 4945 as applicable to private foundations. ORG has never filed a form 990PF.

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Requests for information

The Secretary's requests for records and the taxpayer's responses are listed below.

December 14, 20XX, a cover letter and Information Document Request, (IDR # 1) was sent to Address, City, State, the address of record according to Internal Revenue Service records. This letter was returned "Not Deliverable as Addressed Unable to Forward". IDR # 1 requested among other things:

- Form 990-PF for tax period ending December 31, 20XX.
- Governing Instruments, i.e. bylaws, code of regulations to verify the exempt purpose, proscription against inurement, and provision on dissolution.
- Advance approval letter from the I.R.S. regarding grant-making procedures plus grant files to learn what grant making procedures are utilized by the organization and the purpose for which grants are made and whether funds were used for such purposes.
- Minute Books of recorded meetings of officers, directors, and trustees to determine whether the organization has sufficient and adequate internal controls, and business operations conducted by the organization.
- Financial records; such as chart of accounts, general ledger, trial balance, cash disbursements journal, bank statements, cancelled checks, etc., to determine whether items of expense were fair and reasonable to the organization.

January 12, 20XX, a cover letter and a copy of IDR # 1 was sent to Address, City State, the address provided on Form 1023, Application for Recognition of Exemption . No reply was received.

February 20, 20XX, a cover letter and a copy of IDR # 1 were sent to Address, City, State, the address provided on ORGs bank statement. No reply was received.

April 4, 20XX, a fax reply was received from Trustee, CEO, indicating he had received the Secretary's request, but none of the requested information was provided.

April 25, 20XX, a cover letter, IDR # 2, and Analysis of Bank Statements from 20XX and 20XX was faxed to CEO at on April 25, 20XX. No reply was received. IDR # 2 requested:

- An explanation of Deposits and withdrawals as they relate to the Private Foundation.
- If any funds were distributed to other charitable organizations, provide verification of the distributions.
- List any property which was transferred to the Foundation, pursuant to the Trust Agreement entered into on July 13, 20XX.

July 27, 20XX, a cover letter, IDR # 2, and Analysis of Bank Statements from 20XX and 20XX was sent to Address, City, State. No reply was received.

September 28, 20XX - A fax reply was received from Trustee, CEO stating he has tried on a continuous basis to get a word from his tax provider and he had not had any contact. None of the requested information from IDR # 2 was provided.

October 11, 20XX, a fax was sent to CEO at requesting a response to IDR # 2.

February 1, 20XX, IDR # 3, copies of cancelled checks and a list of all transactions occurring in 20XX and 20XX from account # were sent to Address, City, State. IDR # 3 requested among other things:

- Explain the

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expenditures and how these contributed to your exempt purpose. Please be very specific, since many of the expenditures appear to be for personal use. For example, the truck payments to CO-1, CO-2 and CO-3.

- Statement from CO-4 and CO-5 verifying the purpose of the checks made on 1/25/04 to CO-5 of \$ and 12/9/03 to CO-6 of \$\$.
- Title of the truck showing the Foundation as owner. You stated the truck was sold. Please provide the details of the sale of the truck and what was done with the funds from the sale.
- Form 990-PF for tax periods ending December 31, 20XX and December 31, 20XX.

February 27, 20XX, a reply was received substantiating the contribution of \$ made to CO-5. This was the only information received.

On January 18, 20XX a summons of records pertaining to ORG's was issued to bank used by ORG, requesting all books, papers, records, and memoranda in your custody, possession or control for all account transactions, and dealings with, for or on behalf of ORG for the periods January 1, 20XX through December 31, 20XX for checking account # #. The information received revealed CEO and DIR-1 are authorized to sign checks. Only one signature is required for checks. All canceled checks for 20XX and 20XX were signed by CEO. The account was closed on December 29, 20XX. See Exhibit # 1 for an itemized list of all transactions occurring in 20XX and 20XX.

## LAW:

### Exemption under I.R.C. Section 501(c)(3)

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).

The term "private foundation" is defined in IRC section 509(a). The term includes all organizations, foreign and domestic, described in IRC section 501(c)(3), except the types of organizations set out in IRC sections 509(a) (1), (2), (3), or (4). Thus if an organization is described in IRC section 501(c)(3), it is also a private foundation unless it falls into one of four general categories of organizations excluded under IRC sections 509(a)(1) through (4).

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).

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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".

Rev. Rul. 67-5, 1967-1 C.B. 123, describes a foundation controlled by an insider and operated to enable the insider and his family to engage in financial activities beneficial to them and detrimental to the foundation. The ruling holds that the foundation was operated for a substantial nonexempt purpose and served the private interest of the insider and his family and thus not entitled to exemption under section 501(c)(3) of the Code.

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)

#### Adequate Records and Filing Requirement

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.

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.

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 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. § 1.6033-1(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



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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.

IRC § 7491(a) provides the burden shifts where taxpayer produces credible evidence.--

(1) General rule.--If, in any court proceeding, a taxpayer introduces credible evidence with respect to any factual issue relevant to ascertaining the liability of the taxpayer for any tax imposed by subtitle A or B, the Secretary shall have the burden of proof with respect to such issue.

(2) Limitations.--Paragraph (1) shall apply with respect to an issue only if--

(A) the taxpayer has complied with the requirements under this title to substantiate any item;

(B) the taxpayer has maintained all records required under this title and has cooperated with reasonable requests by the Secretary for witnesses, information, documents, meetings, and interviews; and

(C) in the case of a partnership, corporation, or trust, the taxpayer is described in section 7430(c)(4)(A)(ii).

### **TAXPAYER'S POSITION:**

The Taxpayer's position is unknown.

### **GOVERNMENT'S POSITION:**

CEO was founder, trustee, and signor on all the checks. He therefore controlled the organization. It is the Service's position ORG failed to meet the reporting requirements under IRC § 6033, since it refused to file Form 990-PF for tax years ending 20XX, 20XX, and 20XX. ORG also failed to keep adequate records as required under IRC § 6001 and did not respond to reasonable attempts to secure information to determine whether it qualified for exemption. Since no documentation was provided to show the checks were issued for charitable purposes, we would conclude that, in fact, the checks were issued for the benefit of the Trustee, CEO, resulting in inurement.

Thus the conclusion reached is that the Foundation was operated primarily for private benefit and thus had a substantial non-exempt purpose.

### **CONCLUSION:**

The tax exempt status of ORG is revoked effective January 1, 20XX, thereby making it a taxable private foundation from that day forward. This Foundation is required to file Forms 1041, US Income Tax Return for Estates and Trusts as well as Form 990-PF. In addition it is required to file Form 4720, Return for Certain Excise Taxes on Charities and Other Persons under Chapters 41 and 42 of the Internal Revenue Code should ORG engage in activities giving rise to excise tax.