

Internal Revenue Service
Appeals Office
2525 Capitol Street, Suite 201
Fresno, CA 93721

Department of the Treasury

Taxpayer Identification Number:
D

Release Number: 201417019
Release Date: 4/25/2014
Date: January 29, 2014

Person to Contact:

Tel:
Fax:

A
B

Tax Period(s) Ended:
C

UIL: 501.01-01

Certified Mail

Dear

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the internal Revenue Code ("Code"). Our favorable determination letter to you dated February 28, 1994 is hereby revoked and you are no longer exempt under section 501(a) of the Code effective January 1, 2008.

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

You are not operated exclusively for any charitable purpose, education purpose, or any other exempt purpose. Our examination reveals that you are not engaged primarily in activities which accomplish charitable, educational, or any other exempt purpose as required by Treas. Reg. section 1.501(c)(3)-1(c)(1). Your activities, including your financial transactions, more than insubstantially furthered non-exempt purposes and your income inured to the benefit of private shareholders and individuals. In addition, you operated for the benefit of private, rather than public interests, as required for continued recognition of exemption pursuant to Treas. Reg. section 1.501(c)(3)-1(d)(1)(ii).

Contributions to your organization are no longer deductible under section 170 of the Code after January 1, 2008.

You are required to file Federal income tax returns on Forms 1120. These returns with the appropriate Service Center for the tax year ended December 31, 2008 and for all tax years thereafter in accordance with the instructions of the return.

Pursuant to section 509(a) of the Code, your private foundation status continues unless your status as such is terminated under section 507 of the Code. Therefore, in addition to the filing Form 1120, you are required to continue filing Form 990-PF and you are still subject to excise taxes under Chapter 42 of the Code until such time as you terminate your private foundation status under section 507 of the Code.

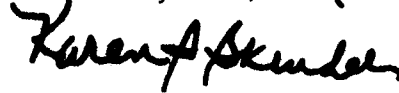
Processing of income tax returns and assessments of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Internal Revenue Code

If you decide to contest this determination, under the declaratory judgment provisions of section 7428 of the Code, you may file a petition to 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 to one of these three courts must be filed before the 91st day after the date of this determination was mailed to you. Please 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. See also Publication 892.

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 matters that may not have been resolved through normal channels get prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit www.irs.gov/advocate for more information.

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

Sincerely Yours,

A handwritten signature in black ink, appearing to read "Karen A. Skinder". The signature is written in a cursive style with a large initial "K".

Appeals Team Manager
Karen A. Skinder

Enclosure:

Pub 892

Internal Revenue Service
Tax Exempt and Government Entities Division
Exempt Organizations: Examinations
100 SW Main Street, Ste. 1200.
M/S O-540
Portland, OR 97204

Department of the Treasury

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.

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,

For Nannette M. Downing
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination
Form 6018

Form 886-A (Rev. January 19XX)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer ORG	Tax Identification Number EIN	Year/Period ended 12/ 31/20XX – 12/31/20XX

Legend:

ORG - Organization name XX - Date EIN - ein Address - address City -
city State - state Founder - founder President - president Vice-
President - vice president Secretary - secretary DIR-1 - 1st DIR RA-1 - RA-
3 - 1st through 3rd RA CO-1 through CO-7 - 1st through 7th COMPANIES

Issues:

- 1) Should the tax exempt status of a private foundation that operates a facility for the care and education of persons with autism be revoked for multiple acts of self dealing, failing to achieve its exempt purpose, and inadequate recordkeeping?
- 2) If so, should the organization be subject to tax under Internal Revenue Code (IRC) section 507(c) as a result of this revocation?

Facts:

- 1) The subject organization is a private foundation named ORG (ORG) and is located at Address, City, State. It is set on 18 acres consisting of two lots that are a part of a much larger plot (approximately 120 acres) outside the city of City.
- 2) The ORG submitted a Form 1023 application for exempt status in August of 19XX and on February 28, 19XX was granted provisional status as a publicly supported organization exempt under IRC section 501(c)(3) and 170(b)(1)(A)(vi) during its advance ruling period (retroactive starting date of December 19XX). The exempt purpose of the organization as stated in the application was to create and operate an autism center to provide shelter and support for approximately 40 individuals. The funding for this operation was to be subsidized by an elderly care home and long term care facility, public contributions and government grants.
- 3) The ORG was unable to meet the public support test as of the end of its advance ruling period and was reclassified to a non-operating private foundation.
- 4) The Forms 990 for 20XX, 20XX and 20XX listed no direct charitable activities during these years.
- 5) The Forms 990 for 20XX provided information regarding the ORG activities during this year (under Part IX Summary of Program Related Investments) as "Renting homes to university students at substantially low rate. Maintain existing facilities. Continue to establish a program for autistic children." The 20XX Form 990 reads "Maintain existing facilities. Continue to establish a program for autistic children."
- 6) The officers of the organization, as listed on the Form 990 filed for 20XX and 20XX were as follows:
 - 20XX: President – President
Vice President/Treasurer – Treasurer
Secretary – Secretary
 - 20XX: President/Director – Treasurer
Vice President- President
Treasurer – Secretary
Secretary – Secretary
Director – DIR-1
 - 20XX: President – Treasurer
Vice President-DIR-1
Treasurer – Secretary

Form 886-A (Rev. January 19XX)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
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- 7) The funding of the ORG per the Forms 990 filed for the year 20XX showed contributions from a disqualified person (Vice President of the ORG in 20XX and President in 20XX/20XX) as the sole contributor for these years. It also reported interest/dividend income and rental income (which was reported at a net loss).
- 8) The 20XX and 20XX Forms 990 reported total income for the year of \$. There were no contributions, donations or program service revenues in these years.
- 9) The income producing activities listed on the 20XX Form 990 was "Rental for students."
- 10) The son of the disqualified person was a resident at the facility for approximately 250 days each year from 20XX through 20XX.
- 11) Other than the son of the disqualified person, there were no autistic residents at the facility in 20XX, 20XX or 20XX.
- 12) The property owned by the exempt organization consists of ten residential structures (Labeled 0 through 9) and two storage buildings constructed upon 18.49 acres of land. Building 0 is 1184 square feet two bedroom single family residence and was constructed on the property in the 19XX's. Construction on Unit 1 was begun in 19XX. It is 3,788 square feet and includes an office area, bath, kitchen, great room, and laundry area and there are two separate ells off the great room. One ell has two bedrooms, a snack area and a shared bath and the second ell has three bedrooms with two with shared baths, a snack area and computer room. In January of 19XX, the land and buildings were transferred to the ORG from the Treasurer Trust and were valued at a cost of \$. A building permit was issued for Unit 2 was in 19XX and has three bedrooms with private baths as well as living, dining, kitchen and laundry areas in a 2,238 square foot structure. Building permits were issued for Units 4 through 9 were in 20XX. Each of these units are 2,056 square feet and include four bedrooms with two shared baths, living, dining, kitchen, laundry and office areas. Total cost basis for all completed buildings and land equaled \$.
- 13) Officer Treasurer is a % owner of a construction supply company (CO-1) which provided all of the building materials for the construction noted above.

Law:

INTERNAL REVENUE CODE:

SECTION. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.

501(c)(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

SECTION 507 TERMINATION OF PRIVATE FOUNDATION STATUS

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Name of taxpayer ORG	Tax Identification Number EIN	Year/Period ended 12/ 31/20XX – 12/31/20XX

(a) General rule.--Except as provided in subsection (b), the status of any organization as a private foundation shall be terminated only if--

(1) such organization notifies the Secretary (at such time and in such manner as the Secretary may by regulations prescribe) of its intent to accomplish such termination, or

(2)(A) with respect to such organization, there have been either willful repeated acts (or failures to act), or a willful and flagrant act (or failure to act), giving rise to liability for tax under chapter 42, and

(B) the Secretary notifies such organization that, by reason of subparagraph (A), such organization is liable for the tax imposed by subsection (c), and either such organization pays the tax imposed by subsection (c) (or any portion not abated under subsection (g)) or the entire amount of such tax is abated under subsection (g).

(c) Imposition of tax.--There is hereby imposed on each organization which is referred to in subsection (a) a tax equal to the lower of--

(1) the amount which the private foundation substantiates by adequate records or other corroborating evidence as the aggregate tax benefit resulting from the section 501(c)(3) status of such foundation, or

(2) the value of the net assets of such foundation.

(g) Abatement of taxes.--The Secretary may abate the unpaid portion of the assessment of any tax imposed by subsection (c), or any liability in respect thereof, if--

(1) the private foundation distributes all of its net assets to one or more organizations described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)) each of which has been in existence and so described for a continuous period of at least 60 calendar months, or

(2) following the notification prescribed in section 6104(c) to the appropriate State officer, such State officer within one year notifies the Secretary, in such manner as the Secretary may by regulations prescribe, that corrective action has been initiated pursuant to State law to insure that the assets of such private foundation are preserved for such charitable or other purposes specified in section 501(c)(3) as may be ordered or approved by a court of competent jurisdiction, and upon completion of the corrective action, the Secretary receives certification from the appropriate State officer that such action has resulted in such preservation of assets.

SECTION 4946. DEFINITIONS AND SPECIAL RULES

(a) Disqualified person.-- (1) In general.--For purposes of this subchapter, the term "disqualified person" means, with respect to a private foundation, a person who is--

(A) a substantial contributor to the foundation,

(B) a foundation manager (within the meaning of subsection (b)(1)),

(C) an owner of more than 20 percent of--

(i) the total combined voting power of a corporation,

(ii) the profits interest of a partnership, or

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(iii) the beneficial interest of a trust or unincorporated enterprise, which is a substantial contributor to the foundation,

(D) a member of the family (as defined in subsection (d)) of any individual described in subparagraph (A), (B), or (C),

(E) a corporation of which persons described in subparagraph (A), (B), (C), or (D) own more than 35 percent of the total combined voting power,

(F) a partnership in which persons described in subparagraph (A), (B), (C), or (D) own more than 35 percent of the profits interest,

(G) a trust or estate in which persons described in subparagraph (A), (B), (C), or (D) hold more than 35 percent of the beneficial interest,

(H) only for purposes of section 4943, a private foundation--

(i) which is effectively controlled (directly or indirectly) by the same person or persons who control the private foundation in question, or

(ii) substantially all of the contributions to which were made (directly or indirectly) by the same person or persons described in subparagraph (A), (B), or (C), or members of their families (within the meaning of subsection (d)), who made (directly or indirectly) substantially all of the contributions to the private foundation in question, and

(I) only for purposes of section 4941, a government official (as defined in subsection (c)).

(2) Substantial contributors.--For purposes of paragraph (1), the term "substantial contributor" means a person who is described in section 507(d)(2).

INCOME TAX REGULATIONS:

REGULATIONS § 1.501(c)(3)-1 Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

(a) Organizational and operational tests. (1) In order to be exempt as an organization described in section 501(c)(3), an organization 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 test or the operational test, it is not exempt.

(b) Organizational test--(1) In general. (i) An organization is organized exclusively for one or more exempt purposes only if its articles of organization (referred to in this section as its articles) as defined in subparagraph (2) of this paragraph:

(a) Limit the purposes of such organization to one or more exempt purposes; and

(b) Do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

(ii) In meeting the organizational test, the organization's purposes, as stated in its articles, may be as broad as, or more specific than, the purposes stated in section 501(c)(3). Therefore, an organization which, by the terms of its articles, is formed for literary and scientific purposes within the meaning of section 501(c)(3) of

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the Code shall, if it otherwise meets the requirements in this paragraph, be considered to have met the organizational test. Similarly, articles stating that the organization is created solely to receive contributions and pay them over to organizations which are described in section 501(c)(3) and exempt from taxation under section 501(a) are sufficient for purposes of the organizational test. Moreover, it is sufficient if the articles set for the purpose of the organization to be the operation of a school for adult education and describe in detail the manner of the operation of such school. In addition, if the articles state that the organization is formed for charitable purposes, such articles ordinarily shall be sufficient for purposes of the organizational test (see subparagraph (5) of this paragraph for rules relating to construction of terms).

(iii) An organization is not organized exclusively for one or more exempt purposes if its articles expressly empower it to carry on, otherwise than as an insubstantial part of its activities, activities which are not in furtherance of one or more exempt purposes, even though such organization is, by the terms of such articles, created for a purpose that is no broader than the purposes specified in section 501(c)(3). Thus, an organization that is empowered by its articles to engage in a manufacturing business, or to engage in the operation of a social club does not meet the organizational test regardless of the fact that its articles may state that such organization is created for charitable purposes within the meaning of section 501(c)(3) of the Code.

(c) Operational test--(1) Primary activities. An organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

REGULATIONS §1.6001-1. RECORDS

(a) *In general.* —Except as provided in paragraph (b) of this section, any person subject to tax under subtitle A of the Code (including a qualified State individual income tax which is treated pursuant to section 6361(a) as if it were imposed by chapter 1 of subtitle A), or any person required to file a return of information with respect to income, shall keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by such person in any return of such tax or information.

(b) *Farmers and wage-earners.* —Individuals deriving gross income from the business of farming, and individuals whose gross income includes salaries, wages, or similar compensation for personal services rendered, are required with respect to such income to keep such records as will enable the district director to determine the correct amount of income subject to the tax. It is not necessary, however, that with respect to such income individuals keep the books of account or records required by paragraph (a) of this section. For rules with respect to the records to be kept in substantiation of traveling and other business expenses of employees, see §1.162-17.

(c) *Exempt organizations.* —In addition to such permanent books and records as are required by paragraph (a) of this section with respect to the tax imposed by section 511 on unrelated business income of certain exempt organizations, every organization exempt from tax under section 501(a) shall keep such permanent books of account or records, including inventories, as are sufficient to show specifically the

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items of gross income, receipts and disbursements. Such organizations shall also keep such books and records as are required to substantiate the information required by section 6033. See section 6033 and §§1.6033-1 through -3.

(d) *Notice by district director requiring returns, statements, or the keeping of records.* —The district director may require any person, by notice served upon him, to make such returns, render such statements, or keep such specific records as will enable the district director to determine whether or not such person is liable for tax under subtitle A of the Code, including qualified State individual income taxes, which are treated pursuant to section 6361(a) as if they were imposed by chapter 1 of subtitle A.

(e) *Retention of records.* —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 so long as the contents thereof may become material in the administration of any internal revenue law [Reg. §1.6001-1.]

REGULATIONS §53.4941(d)-1. DEFINITION OF SELF-DEALING

(a) *In general.* —For purposes of section 4941, the term “self-dealing” means any direct or indirect transaction described in §53.4941(d)-2. For purposes of this section it is immaterial whether the transaction results in a benefit or a detriment to the private foundation. The term “self-dealing” does not, however, include a transaction between a private foundation and a disqualified person where the disqualified person status arises only as a result of such transaction. For example, the bargain sale of property to a private foundation is not a direct act of self-dealing if the seller becomes a disqualified person only by reason of his becoming a substantial contributor as a result of the bargain element of the sale. For the effect of section 4942, 4943, 4944, and 4945 upon an act of self-dealing which also results in the imposition of tax under one or more of such sections, see the regulations under those sections.

(b) *Indirect self-dealing*

(1) *Certain business transactions.* —The term “indirect self-dealing” shall not include any transaction described in §53.4941(d)-2 between a disqualified person and an organization controlled by a private foundation (within the meaning of subparagraph (5) of this paragraph) if —

(i) The transaction results from a business relationship which was established before such transaction constituted an act of self-dealing (without regard to this paragraph),

(ii) The transaction was at least as favorable to the organization controlled by the foundation as an arm's-length transaction with an unrelated person, and

(iii) Either —

(a) The organization controlled by the foundation could have engaged in the transaction with someone other than a disqualified person only at a severe economic hardship to such organization, or

(b) Because of the unique nature of the product or services provided by the organization controlled by the foundation, the disqualified person could not have engaged in the transaction with anyone else, or could have done so only by incurring severe economic hardship. See example (2) of subparagraph (8) of this paragraph.

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WENDY L. PARKER REHABILITATION FOUNDATION, INC. v. COMMISSIONER OF INTERNAL REVENUE, T.C. Memo. 1986-348

Wendy Parker is one of an unspecified number of recovering coma patients. She is the daughter of both the petitioner's President and the Secretary-Treasurer, and the sister of petitioner's Vice President. George Parker, Phyllis Parker and Perry Parker, as officers and directors of a foundation formed to benefit coma patients, including Wendy Parker, have a personal interest in petitioner's affairs to provide assistance, including financial aid, to Wendy Parker and other coma patients. In addition, they are 'private individuals' within the meaning of section 1.501(a)-1(c), Income Tax Regs.

The distribution of funds for the benefit of Wendy Parker assists the Parker family in providing for her care. These funds will be used to pay for the medical and rehabilitative care of Wendy Parker. This relieves the Parker family of the economic burden of providing such care. Consequently, there is a prohibitive benefit from petitioner's funds that inures to the benefit of private individuals.

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

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

Taxpayer's Position:

The organization has not yet provided a position and, with this writing, is being given the opportunity to respond.

Government's Position:

The Service submits that the organization does not qualify for exempt status under Internal Revenue Code (IRC) section 501(a) for the following reasons:

- a) The organization is not operating exclusively for an exempt purpose in that:
 - 1) RA-1, the child of Treasurer (who is the founder and President during 20XX) of the organization is the primary beneficiary of the operations of the organization and no payments were made by Treasurer to the organization for the services received. Both are

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considered “disqualified persons” per the definition of this term in IRC section 4946. This constitutes inurement which is prohibited under IRC section 501(c).

- 2) The organization conducted no exempt activities in 20XX, 20XX or 20XX. During 20XX, it rented its unoccupied houses to a for-profit LLC of which Treasurer was a member and the Registered Agent. This is not an activity which furthers the organization’s exempt purpose.
- 3) Funds of the ORG were diverted by the founder of the organization during the years under examination. The diverted funds were transferred to other accounts under the control of founder or paid from the ORG account for personal expenses of the founder. There was no documentation to show there was a legitimate exempt purpose for the transfers or payments made. This constitutes inurement (or, in the case of private foundations, self dealing) which is prohibited under IRC Section 501(c).
- 4) As a result of multiple acts of self dealing, the organization and or its managers would be subject to tax under IRC Section 4941.
- 5) The ORG failed to maintain appropriate records necessary to support the exempt purpose of use and/or distribution of the organization’s assets, its income and expenses reported on the Form 990’s for the years under examination as required by law. These records were material to the determination as to whether or not the organization should retain its exempt status and the organization was informed of the potential loss of exempt status as a consequence of failing to provide this information in a letter dated January 19, 20XX.

The founder of the ORG is Founder (Founder). As noted in the facts section above, Founder is listed as the Vice President of the organization for 20XX and the President of the organization for 20XX and 20XX.

The organization leased the facility to another exempt organization named CO-2 that agreed to operate a group home for autistic children from 20XX to 20XX, however, due to a loss of funding, was unable to continue the operation of the facility after that point. During the time it ran the operation, it was unable to attract more than five residents. In addition, in 20XX and 20XX, the organization rented space as housing for students of CO-3 for which it received citations from the City of City for violation of its conditional use permit which only allowed use of the property as a center for autistic children.

Founder has a son named RA-1 (RA-1) who is autistic. RA-1 lived in one of the organization houses from 20XX through 20XX as an adult resident. During the years under examination, he was the sole autistic resident at the facility and, per written testimony provided by Treasurer, lived there in excess of 250 days per year. In addition to RA-1, there were caregivers for RA-1 who also lived at the facility that were in the employ of Founder. There are three caregivers for RA-1 whose names are Secretary (Secretary), RA-2 (RA-2), and RA-3 (RA-3). As noted in the facts section above, Secretary is listed as the Secretary of the organization on the 20XX Form 990 and as Treasurer of the organization on the 20XX and 20XX Forms 990. The fair rental value of the use of the organization’s assets and services was determined to be \$ per year for the years under examination. No payments were received by the organization from Founder. The personal use of the assets of the organization are considered acts of self dealing. In addition, such acts are specifically prohibited under State state laws regarding the operation of private foundations. Founder failed to notify the accountant who prepared the Forms 990-PF of this personal use which supports a position that

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she was aware that this would result in personal tax liability and knowingly continued these self dealing transactions.

Checks (# & #) were written to RA-2 and RA-3 in the amount of \$0 each from the organization account on March 30, 20XX. The notation on the checks reads "Care for RA-1." This care is a personal expense for Founder. The verbal testimony provided by the Power Of Attorney indicated these payments were for cleaning and maintenance services provided by these individuals for the foundation. No documentation was provided to substantiate this position. This verbal testimony is not considered credible due to the contemporaneous documentation which conflicts with the testimony provided. These payments constitute inurement and are considered acts of self dealing.

There was one check (#) written to Treasurer on January 17, 20XX in the amount of \$. There were two more checks (# & #) written to the Treasurer Trust account on January 24, 20XX and January 25, 20XX, respectively for \$ each. According to verbal testimony provided by the power of attorney, these checks were repayments of loans made to the organization by Founder or the Trust in the prior year. No loan documents or other evidence was provided to support this position or to show any other exempt purpose for the expenditure. These diversions of the exempt organization's funds for which no exempt purpose could be established were determined to be acts of self dealing.

The 20XX Form 990 reported gross rental income of \$ as a program related investment, but showed the net rental activity resulted in a loss of \$. No documentation was provided to show any allocation of expenses for the rental activity. No substantiation was provided for any rental expenses. The general ledger spreadsheet showed that the total expenses incurred by the organization during 20XX equaled \$. This would mean that, even though the rental activity only occurred for the first three months of the year, the expenses were allocated at % toward the rental activity.

INCOME

Gross Rents

EXPENSES

- Interest
- Bank Fees
- CO-6
- Utilities
- CO-4
- CO-5
- CPA
- Contracted Labor
- Other
- Electricity
- Legal

Expenses

Net loss
Rental loss reported

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Expenses not related to renting
Percentage of total expenses allocated to rental activities
Percentage of total expenses allocated to exempt activities

The general ledger shows that the majority of the expenses were incurred after the rental activity ended. There were three expenses listed for 20XX from January through March of 20XX and the total amount of these expenses equaled \$. It appears that the organization improperly allocated various expenses to the rental activity.

The Summary of Program Related Investments statement on the Form 990 for Page 7 Part IX-B reads: "Renting home to university students at substantially low rate." Further the Relationship of Activities to the Accomplishment of Exempt Purposes explanation on Page 12 Part XVI-B reads: "ORG was established to build and operate a residential care home for autistic children. The Foundation has been renting its facility to university students (sic) on a month to month basis pending the establishment of the autistic children program."

The review of the organization's checking account deposit items for the rental income reported on the 20XX general ledger revealed that the rental income reported consisted of payments of \$ per month in January, February and March of 20XX from a for-profit company named CO-7 (LLC) which was formed in July of 20XX. The State of State Corporation Division shows that Founder was listed as the registered agent for the entity and as a member of the LLC. There is no indication that she was removed as a member at any time before it was administratively dissolved in June of 20XX. The POA provided a statement which indicates Founder had no knowledge that her name was used in the registration of the LLC, and that the Foundation did rent the organization facility to the LLC for three months, but no lease agreement could be located. This verbal testimony is not considered credible given that the State of State sends notices of renewal to the registered agent on file on an annual basis. No other rental income was reported on the Form 990 for 20XX. The current president (President) has disputed the information on the return which refers to rentals to university students. Per her verbal testimony, the rentals to students were stopped in 20XX at the end of the spring term. The review of the 20XX and 20XX Forms 990 reflects rental income received of approximately \$ and \$\$ respectively. The real property rentals were the primary activity of the organization from 20XX through 20XX. While the rental of the real property owned by the exempt organization does not constitute unrelated business income per IRC section 512, it cannot be considered to be in furtherance of the organization's exempt purpose.

As noted in the facts section, Founder was % owner of a construction supply company which provided the materials for all of the construction of the ORG facilities. There was no documentation retained to show that competitive bids had been solicited for the construction or that the construction costs were at or below fair market value. This information was necessary to determine whether the transactions should be considered an act of self dealing under IRC Section 4941. The value assigned to the improvements to the property (at cost) per the depreciation schedule was in excess of \$ for construction completed between 19XX and 20XX. According to the power of attorney, all funding for the construction and operation of the facility since its inception has been, primarily, from Founder or a trust set up by Founder called Founder Trust (Trust) and either Founder or the Trust deducted the construction costs throughout the years as a charitable contribution on the Trust Form 1041 or (for the 20XX tax year) on Founder's Form 1040.

Various factors indicate that Founder's actions were done with full knowledge that these expenditures may violate the law governing taxable expenditure in that she was solely in control of the finances of the

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organization and was the only person to receive payments or write checks from the organization's account for all expenditures. Founder has an understanding of finance and business law through her ownership and operation of other for profit entities yet failed to demonstrate ordinary business care in either the creation of rental agreements or the maintenance of records related to the activity of the organization. Founder also has access to financial and legal advice through her accountant and attorney. In addition, Founder failed to notify the accountant preparing the tax return of the various transactions that occurred and, when confronted with the evidence, provided responses that were in direct conflict with the third party documentation (notations on the checks, documentation from the corporation division regarding ownership in related organizations) in an attempt to either claim a legitimate exempt purpose for the expenditure or to claim ignorance. These factors also indicate willfulness on the part of the disqualified person in that these actions (both original and subsequent) demonstrate voluntary, conscious and intentional acts.

Conclusion:

As noted in the government's position, a disqualified person (Founder) of the organization has, through both action and inaction, knowingly committed multiple willful acts of self dealing as defined in Federal Tax Regulation 53.4941 including:

- 1) Having used the income or assets of the private foundation through the payment of personal bills, and by the placement of her autistic son at the facility during the years under examination. As in the court case cited (WENDY L. PARKER REHABILITATION FOUNDATION, INC. v. COMMISSIONER OF INTERNAL REVENUE), the use of the facilities at no charge and the use of the organization's fund to pay personal bills relieves the Founder family of the economic burden of providing care for the autistic son. Consequently, there is a prohibitive benefit from the use of organization's funds and facilities that inured to the benefit of the disqualified person.
- 2) Having conducted transactions between the foundation and a corporation, partnership or trust not owned by the foundation in which disqualified persons own more than % of the total voting power or profits or beneficial interest. Specifically, the disqualified person provided construction materials and/or services to the private foundation without having made a good faith effort to establish fair market value for the materials/services provided. This resulted in significant profit to the for profit corporation of the disqualified person. In addition, the disqualified person or her trust gained significant tax benefit in the form of charitable deductions for the value assigned to the materials/service.
- 3) Having distributed the funds of the organization to disqualified persons where no exempt purpose for the distribution had been established or for personal expenses of the disqualified person. Specifically, checks were written to Founder and a trust operated by Founder in the amount of \$ and checks were written from the organization account for care of the President's son in the amount of \$.

In addition, the organization has failed to provide the documentation requested or to maintain adequate records which are necessary to establish the validity of the income reported, exempt purpose and amount of expenditures from the organization's funds and the proper valuation of the assets of the organization as required by law and as needed for the determination of any tax due. The organization had been properly informed of the potential loss of exempt status for failing to provide the requested information.

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Despite multiple attempts to develop a center for autistic children and to attract participation from other organizations involved with assisting autistic children and their families since its inception in 19XX, the organization has been unable to achieve its exempt purpose. This has resulted in the creation and operation of multiple activities which are not in furtherance of the organization's exempt purpose (specifically, rental to students, rental to the related for-profit care home).

The current President of the organization (President) was offered a managerial conference regarding the revocation. This offer was accepted. The meeting was held via teleconference on December 7, 20XX. As a result, President was granted an extension of time (originally February 28, 20XX and an additional extension to March 31, 20XX) to provide additional documentation to show that no inurement took place and that the organization could begin providing services which would support its exempt purpose. President was unable to provide the required documentation or to show that the organization had been successful in beginning to provide the services as indicated.

Based upon these factors, the organization's exempt status should be revoked and all assets of the organization should be distributed to another organization exempt under IRC section 501(c)(3) or to the state or federal government.

Because the foundation manager (Founder) has knowingly participated in multiple acts of self dealing, the organization is being terminated as per IRC section 507(a)(2). This type of termination will result in taxes against the organization in an amount equal to the market value of the assets of the organization as noted in IRC section 507(c). However, the unpaid amount of these taxes may be abated provided the assets of the private foundation are properly distributed to an organization that meets the qualifications noted under IRC section 507(g).