Internal Revenue Service
Appeals Office

Date: AUG 2 1 2014

Number: **201446029**
Release Date: 11/14/2014

Organization
c/o
Street
City, State, Zip Code

Certified Mail

Department of the Treasury

Employer Identification Number:

Person to Contact:

Employee ID Number:
Tel:
Fax:

UIL: 501.03-30

Dear

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

Our revocation was made for the following reasons:

> You are not operated exclusively for one or more exempt purposes as required by section 501(c)(3) of the Code. You are operated in part to provide tax benefits and investments to private individuals. You have also made disbursements of funds to your president and paid personal expenses of your president. You are therefore operated for a substantial purpose of benefitting private interests.
>
> Additionally, your net earnings inure to the benefit of private shareholders or individuals. Specifically, you have made disbursements of funds to your president and paid personal expenses for your president.

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

You are required to file Federal income tax returns on Forms 1120. File your return with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit www.irs.gov.

If you were a private foundation as of the effective date of the adverse determination, you are considered to be taxable private foundation until you terminate your private foundation status under section 507 of the Code. In addition to your income tax return, you must also continue to file Form 990-PF by the 15th Day of the fifth month after the end of your annual accounting period.

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

We will make this letter and the proposed adverse determination letter available for public inspection under Code section 6110 after deleting certain identifying information. We have provided to you, in a separate mailing, Notice 437, *Notice of Intention to Disclose*. Please review the Notice 437 and the documents attached that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437.

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 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,

Acting Appeals Team Manager

CC:

Enclosure: Publication 892 and/or 556

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

May 22, 2012

Taxpayer Identification number:

Form(s):

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 youaccept 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:

1f 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,

Nanette M. Downing
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination
Form 6018

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS		Schedule number or exhibit
Name of taxpayer ORG		Tax Identification Number	Year/Period ended 20XX – 20XX

LEGEND
ORG - Organization name XX - Date Address - address City - city State - state President - president BOD-1 though BOD-9 - Board of Directors 1 through 9 CO-1 through CO-22 - 1st through 22nd COMPANIES Investor-1 through Investor-4 Law Firm through Law Firm Partner-1 through Partner-6 Partnership-1 through Partnership-11 Apartments-1 through Apartments-6

ISSUE:

Whether the ORG qualifies for tax exempt status under section 501(c)(3) of the Internal Revenue Code (the Code):

(1) Whether ORG operated for non-exempt purposes to a more than insubstantial extent.
(2) Whether ORG operated a scheme to mislead investors in order to maintain the operation of an insolvent organization and benefit the founder and some initial investors.
(3) Whether ORG promoted investments in which a false basis in property was created in order to produce inappropriate deductions in income tax
(4) Whether net earnings inured to the benefit of private individuals.

FACTS:

Background:

ORG was established in 19XX by President, as a non-profit corporation in State; it was recognized by the Internal Revenue Service as an organization described in section 501(c)(3) of the Internal Revenue Code in that same year. ORG filed Forms 990, Information Return of an Organization Exempt from Income Tax under Section 501(c), for the calendar years 20XX, 20XX, and 20XX. Form 990s for 20XX and 20XX were filed delinquent on November 15, 20XX, and December 15, 20XX, respectively.
See **Exhibits 0-1, 0-2, 0-3, and 0-4.**

The purpose of ORG as stated on its Form 1023, Application for Recognition of Exemption is as follows:

> The foundation will facilitate the formation of limited partnerships which will help keep low-income properties as low-income properties for the future. The foundation will use proceeds derived from organization fees to provide grants to the housing cooperatives for education of the public and for the promotion of the positive merits of home ownership for low-income people. In addition, the foundation will provide grants to non-profit organizations which sponsor the formation of cooperatives or subsidized housing and grants to help low income properties to remain safe, crime-free, family conducive, affordable and clean.
> See **Exhibit 1(a).**

ORG owned and operated, directly or indirectly, about 65 affordable housing apartment communities in State, State, State, State, State, State, State, State, State, and States containing 13,417 units. ORG provides a variety of programs and services for its tenants. These include operating neighborhood learning centers through a HUD initiative with GED classes, computer classes, life skills classes, parenting classes, substance abuse prevention presentations, employment readiness classes, and cultural exchange nights. See **Exhibits 1 & 30**. pp. 53-70.

Officers and Board of Directors:

President served as President during all years of operation of ORG from its founding until his death in 20XX. Secretary served as Secretary.

The Board of Directors of ORG from January 1, 20XX through September 20XX consisted of the following:

- Chairman
- BOD-1
- BOD-2 – President's Mother
- BOD-3
- BOD-4, Resident / Community Member
- BOD-5, Resident / Community Member – replaced by BOD-6

See **Exhibit 3.**

Upon President's death on April 1, 20XX, the following Members resigned:

- BOD-2
- BOD-1
- BOD-3

The board was reconstituted in June 20XX with the following members:

- Chairman
- BOD-7
- BOD-8
- BOD-9
- BOD-4, Resident / Community Member
- BOD-6, Resident / Community Member

Chairman, resigned in October 20XX. In November 20XX, BOD-7 a member of the CO-1 who filed the involuntary bankruptcy, was selected as Chairman.

During the years at issue, the board met on February 16, 20XX, April, 20, 20XX, July 20, 20XX, January 25, 20XX, April 18, 20XX, August 1, 20XX, October 31, 20XX, February 12, 20XX, April 28, 20XX, June 8, 20XX, July 1, 20XX, July 13, 20XX, August 4, 20XX, August 18, 20XX, October 30, 20XX, November 13, 20XX, and December 14, 20XX.

Board minutes were maintained and taken by a court reporter through April 20XX. President controlled the agenda, and directed the meetings. The majority of the feedback in the minutes was provided or directed by him. Board approvals were documented in board resolutions. Each board member signed to show approval of ORG board resolutions.

For the years 20XX through 20XX, various board resolutions approved the following actions with respect to related entities:

(a) CO-2 loans in amount of $ to CO-3 **(Exhibit 16(a))**;
(b) CO-4 loan in the amount of $ on November 1, 20XX for CO-5 **(Exhibit 5(a))**;
(c) Sale of CO-6, to CO-7 and Partner-5, **(Exhibit 5(b))** ;
(d) ORG sale of unreported property to CO-8 for $ with **XXXX XXXXXX (Exhibit 5(d))**;
(e) ORG guarantee on 635 Limited Partnership loan in amount of $ **(Exhibit 5(e))**; and
(f) ORG guarantee loan in the amount of $ from CO-9 to CO-10 **(Exhibit 8(a))**

ORG served as the general partner on all the limited partnerships that owned the 65 housing communities. Each housing community limited partnership owns a "Special Purpose Entity" or "SPE" which may be a corporation or LLC. Each SPE has a 1% or less interest in a partnership. As stated in the Form 1023, ORG sets up limited partnerships to provide resources, including funding, for the acquisition of affordable housing properties. Typically, limited partners receive the greater share of tax credits and losses derived from the operations of housing units. Limited partners receive as much as 99% interest in the partnerships. The properties were acquired using limited partnership funding offering Low Income Housing Tax Credits (LIHTC), Conventional Financing, and Bond Financing.

The number of housing communities financed in each way is as follows:

17 by Tax-Credit Equity Financing from investors (with 3,179 units);

13 by conventional financing from (the "CO-11 Portfolio"); and

35 by tax-exempt bond financing including 11 in the "CO-12" portfolio (with 2,098 units). 17 in the "CO-13" portfolio (with 4,730 units), 4 in the "CO-14" portfolio (with 861 units), and 3 in other housing communities.

These total 65 housing communities. See **Exhibits 1 and 2.**

<u>Overview of the Assets of the Organization:</u>

(1) Tax Credit Equity Financing

Seventeen Housing Communities were acquired using this financing method between 19XX and 20XX; of these, 15 were in State, and 2 were in State.

Utilizing low income housing tax credit (LIHTC), ORG sold various partnership interests to various investors. These housing communities are also financed by mortgages. ORG owns very small percentages (normally .001%) in each partnership and is the general partner in these financing arrangements. The 17 partnerships file Forms 1065 and issue Forms K-1 to corporations that file Forms 1120. ORG is 100% owner of these corporations. All were set-up in this manner to avoid general liability insurance. The corporations are shown on Schedule R on the Form 990 filed by ORG.

The housing communities have a 10 year credit life with a 15 year compliance period. If the housing community does not meet the requirements before that time, there are recapture provisions for the tax credits. The State CO-10 Housing Credit Authority (SDHCA) reviews the housing community property for compliance on an annual basis and provides a report to HUD.

(2) **Conventional Financing**

Thirteen housing communities were purchased from CO-11 for $ with conventional financing and were refinanced with [redacted] for a total of $, (All were section 8 properties.) They are owned by limited liability companies that are 100% financed by ORG through [redacted]

(3) Tax Exempt Bond Financing

a. CO-12

These 11 apartment complexes are owned by CO-10. CO-10, in turn, is owned 100% by ORG. The apartment units are managed by the CO-16. CO-12 owes $ to [redacted]

b. CO13

The 18 apartment complexes in CO-13 were also acquired through tax exempt bond financing and are in default.

c. CO-14

The 4 apartment complexes in the CO-14 portfolio were also acquired through tax exempt bond financing for which the bonds are in default. These are 100% owned and operated by ORG; the complexes are managed by CO-15, a third party management company.

d. Other

Three additional apartment complexes were acquired through tax exempt bond financing.

All the apartment complexes are managed by tenant managers, including in-house management, CO-16, and CO-15; these tenant managers, collect rent, operate the facilities, and maintain accounting for each complex.

President used the exempt status of ORG as a marketing element to attract new and existing investors. Finding of Fact 71 of the adversary proceeding by the bankruptcy trustee against Investor-1 in the ORG bankruptcy proceeding summarizes the testimony of investor Investor-1 as follows:

Investor-1 testified that at the November 4, 20XX meeting, President promoted the utilization of "housing tax credits." In doing so, he provided Investor-1 and Investor-2 with various promotional materials, which included a detailed brochure with
financial information and photographs of various housing units; a copy of a January 20XX letter from the IRS regarding an audit of ORG for the 20XX tax year; and a promotional letter from ORG that highlighted the following quote from the IRS audit letter:

> "Our examination of the information return(s) indicated above discloses that your organization continues to qualify for exemption from Federal income tax. Accordingly, we accept the return(s) as filed."

The ORG letter then states that "[t]his no change opinion from the National Office of the IRS equates to the 'GOOD HOUSEKEEPING SEAL OF APPROVAL' for any charitable organization." He also showed them a September 7, 20XX letter from the Law Firm to President that summarizes the IRS's 20XX audit of ORG as comprehensive and highly favorable to ORG".

See **Exhibit 13A p. 23, #71.**

CO-10 (CO-10) and its Relationship to ORG:

CO-10 is a limited partnership created by President and approved by the Secretary of the State of State on September 17, 19XX. See **Exhibits 4, 4(a)/4(c).** ORG is the General Partner of CO-10. The registered address for CO-10 is Address, the same as that of ORG. Secretary served as the Secretary for CO1-, just as she did for ORG. The ORG board passed a corporate resolution on March 23, 20XX, approving President to have full signatory authority and to act as the agent of ORG with full powers to negotiate and execute documents as General Partner of CO-10 in order to borrow $ and establish a banking relationship at CO-17 in City, State. See **Exhibit 5**

In July of 20XX, the Limited Partnership Agreement of CO-10 was amended to change Article II to add that its primary purpose was "to serve or provide investment capital for low-income communities or low income persons." The revised article also stated the purpose contained in the initial partnership agreement, "to acquire, hold, sell, dispose of and otherwise deal with multi-family residential CO-10s." See **Exhibit 6.** Prior to 20XX there was apparently a change in ownership; however, no document was provided to indicate when the change occurred.

The CO-10 partnership was set up in 19XX, with the ownership percentages shown below for the year 19XX and later changed by 20XX as indicated:

Partner Name	19XX	20XX
ORG	2.00%	1.00%
Partner-1	24.50%	16.50%
Partner-1 Trust	24.50%	16.50%

Partner-2	0.00%	16.50%
Partner-3	0.00%	16.50%
Partner-3 Trust	0.00%	16.50%
Partner-4	24.50%	0.00%
Partner-4 Trust	24.50%	16.50%
Total per 19XX partnership agreement	100.00%	100.00%

The 20XX ownership percentages were reflected on CO-10 20XX unfiled partnership return provided by ORG. See **Exhibit 7.** Per statements by both the Controller and Vice President of financial matters, CO-10 was operated in 20XX in the same format as it had operated in the later years.

President, with assistance from ORG employees, directed the acquisition of funds through CO-10. CO-10 did not have any employees or incur any payroll expenses during either 20XX or 20XX. CO-10 did not own or have possession of any property, inventory or other tangible assets during 20XX or 20XX.

CO-10 has existed since 19XX as a limited partnership with investors in related soft-money partnerships. As indicated below, additional similar limited partnerships were in operation during 20XX and 20XX:

Partner Number/Partner Name	Ownership %	Partner Type
1) Partner-5	9.90000%	Limited
2) Partner-6	9.90000%	Limited
3) Partner-7	9.90000%	Limited
4) Partner-8	9.90000%	Limited
5) Partner-2	9.90000%	Limited
6) Partner-1	9.90000%	Limited
7) Partner-3	9.90000%	Limited
8) Partner-1 Trust	9.90000%	Limited
9) Partner-3 Trust	9.90000%	Limited
10) Partner-4 Trust	9.90000%	Limited
11) Secretary	0.50000%	General
12) ORG	0.50000%	General
Totals	100.00000%	

Four entities filed returns for 20XX and claimed losses identified as coming from CO-10. For tax year 20XX only one of these entities, Partner-7, claimed a loss from the CO-10, on its Form 1065. (Note: The use of Partner-7 name for the separate entity is similar to the name of CO-13 properties (tax exempt bond financed property) owned by ORG.)

The amount of the losses claimed by these entities for respective years is shown below:

Partnership Name	20XX Loss Claimed	20XX Loss Claimed
Partner-5	$ ( )	$ -

Form **886-A** (Rev. January 1994)	**EXPLANATIONS OF ITEMS**	Schedule number or exhibit
Name of taxpayer ORG	Tax Identification Number	Year/Period ended 20XX – 20XX

Partner-6	$ ()	$ -
Partner-7	$ ()	$ ()
Partner-8	$ ()	$ -
Totals	$ ()	$ ()

An entanglement of funds is reflected by the ORG board action to guarantee a $ loan from the CO-9 to CO-10. (See **Exhibit 8(a)**). Vice President was in control of CO-9, serving as Vice-President. While this amount was guaranteed by ORG, the loan was made to CO-10. The proceeds from this debt, however, were paid to ORG, according to testimony by Vice President in a bankruptcy proceeding:

> Vice President discussed what he considered when extending credit to CO-10 as well as his theories on lending. He explained that he has a policy against lending to nonprofits because a nonprofit is a "bankruptcy remote entity." He said they are charitable and he equates charity with poverty. He explained his reluctance to get into a situation where he would have to "throw out the poor" in order to foreclose. For these reasons, he insisted the loan be made to CO-10, not ORG, and that he specifically relied upon CO-10 separate corporate existence. Regardless of this reliance, the evidence reveals that Vice President knew the loaned funds went to the ORG "enterprise." He testified that he knew he would not be getting repaid from the primary obligor, CO-10, and, in fact, did not consider CO-10 financial information prior to making the loan. He did, however, look at and rely on financials of President, audited financials of ORG, and information from , ORG's accounting firm. He said the loaned funds were to be used by CO-10 as "enterprise banker" as it saw fit. He believed the borrower should have the discretion to determine the way the money is actually used. Vice President filed proofs of claim for $ against both CO-10 as obligor on the note and against ORG as guarantor of the loan".

See **Exhibit 9**, p. 8.

Vice President's testimony confirms that funds of ORG and CO-10 were comingled. CO-10 was apparently a for-profit stand in for the financial purposes of ORG "enterprise." ORG "enterprise" refers to the complete operations of ORG, CO-10, and all related entities, corporations, partnerships and parties. Vice President admits to knowingly loaning monies to be used by ORG and explaining why he entered into a loan with CO-10. He also referred to the funds he loaned as being distributed to the ORG "enterprise" for whatever purposes it saw fit and referred to CO-10 as the "enterprise banker."

Controller, Controller of ORG, stated on June 29, 20XX, that there were millions of dollars received and disbursed by CO-10 to ORG and related entities including the 65 low income housing units, Mirror Entities (more fully discussed below), and individuals who were purported to be donors and investors in various properties and real estate activities. The agent reconciled the bank records of CO-10 for 20XX and 20XX. The total amount of the deposits for the two years is illustrated below: See **Exhibit 10(a)** and **(b).**

Form **886-A** (Rev. January 1994)	**EXPLANATIONS OF ITEMS**	Schedule number or exhibit
Name of taxpayer ORG	Tax Identification Number	Year/Period ended 20XX – 20XX

Reconciled Bank Account	**20XX12-1065**	**20XX12-1065**	**Totals 2 years**
Total Deposits	$	$	$
Total Disbursements	$	$	$
Totals	$	$	$

The chart shows that CO-10 was used as a conduit account. Most of the monies were placed in the account to be transferred or paid to causes for the ORG enterprise. CO-10 was a holder of funds for ORG. The accounting method and recordkeeping on the books of other factions of ORG were not maintained in the same fashion as that of CO-10.

CO-10 was operated using the services provided by officers and employees of ORG. Controller, Controller, and CFO, CFO, provided substantial services to CO-10. Further, the Controller and CFO maintained all records for CO-10. The CFO would post the items in QuickBooks and upload all CO-10 expenses previously provided in the form of a check ledger prepared by the controller. The CFO, with President's approval, controlled the outcome of CO-10 accounting. This is illustrated by the following excerpt from the Memorandum Opinion by the Bankruptcy Court for the Northern District of State, City Division, concerning the dismissal of CO-10 in its bankruptcy proceeding on August 17, 20XX:

> The evidence at trial further established that CO-10 did have a bank account, the signatories of which were all ORG employees. The account was closed in March of 20XX, several months prior to the bankruptcy filing. CO-10 also had a set of books, QuickBooks or Excel spreadsheet, which was maintained by Controller, an employee of ORG. The entities engaged in unusual accounting practices. CO-10 filed a tax return in 20XX, but such return reflects no income. It had partial financial statements or a partial general ledger for 20XX which do not match the tax return for that year".

See **Exhibit 9,** p. 7.

At the end of the year the audit team from a CPA firm posted journal entries. The CPA firm tested payables, receivables, checks, and provided the correction to journal entries for the Controller to ultimately post. These final numbers were used for the tax returns. The CPA firm would review the CO-10 bank account and Controller's journal entries. The CFO reviewed information with the CPA in order to prepare the year end journal entries and tax returns. The CFO would post the amount at year end as a journal entry to show a liability on ORG's part for the amounts received from CO-10.

The CFO was responsible for posting the adjusting journal entries between ORG and CO-10. The Controller had no role in the uploads. CFO maintained the Quick Books accounts. Controller, Controller, maintained the disbursement list (spreadsheet) of CO-10 and received either invoices or direction from President on when to pay liabilities or to determine whether to transfer monies from CO-10 to ORG or vice versa. CFO CFO and Controller Controller, were responsible for, and reconciled the CO-10 bank account.

The agent summarized the statements made by CFO in an interview on October 12, 20XX as follows:

> CO-10 activity uploads was done on a quarterly basis. President was approving uploads for posting of CO-10 income and expenses to ORG system. Controller, Controller would input deposits and checks and in an excel spreadsheet (check ledger). She would provide him the excel spreadsheet with notations. CFO would record them as entries in QuickBooks. Deposits were logged in like journal entry and a disbursement was logged in like a check. QuickBooks had its own account numbers. Activity in QuickBooks would compare new quarterly trial balance to the previous quarter's trial balance. In order to export or initiate the upload back to ORG he would export a Comma Separated Value (CSV) file. The CSV file would contain certain fields including account number, amount, date, and control number. The YARDI system was programmed to match the QuickBooks account numbers. The upload did not bring over the detail of transactions in CO-10 to the ORG system but rather showed the amount as an upload (similar to journal entry)."

See **Exhibit 11,** p. 3.

The agents inquired of CFO, "Why were you putting information in QuickBooks versus Controller? Considering you had to await his approval, why couldn't she have done this?" His response was summarized in interview notes as follows:

> QuickBooks gave better accounting records than an Excel spreadsheet. President wanted activity to be maintained separate. Just felt like it could not be consolidated since ORG ownership was only 1%. The auditors may have had a separate conversation with ORG regarding consolidation of CO-10, and how it was recorded, but he was not privy to such conversation.

See **Exhibit 11,** p. 3

The manner in which the books were maintained appears to be a duplication of effort. The agents inquired of CFO, "Did you ever question the deduction"? The interview notes state the following as his response: "May have had some discussion with President, however the items existed prior to his conduct business for employment with ORG and auditors approved it every year". See **Exhibit 11**, p. 3.

The agents asked CFO, "Any interaction with auditors"?

The interview notes reflect the following response: "CFO would coordinate the review of all properties and provided information on such properties that ORG owned or managed. He deferred questionable transactions to President". See **Exhibit 11,** p. 3.

The agents also asked, "Did you consider this (CO-10) a legal entity? Why?"

The interview notes record his response as follows: "Did not have any reason to question the legal entity. It was there when he started, and auditors had reviewed it and they did not question it either". CFO stated, "I gave the auditors CO-10 check ledgers and QuickBooks general ledger annually." See **Exhibit 11,** p. 3.

The agents stated that it appears that CO-10 was just a bank account and asked CFO how he described the entity. The agents also asked whether CFO ever felt that there was any wrong doing on the part of ORG or CO-10.

The interview notes record CFO's response as follows: "CFO believed auditors were asking the questions to President and Controller while conducting annual audits and testing items, so, if there was anything to question, the auditors should be the one to determine any wrongdoing. CFO relied on the auditors and President." See **Exhibit 11**, p. 3.

Controller, Controller, has worked for ORG from April 1, 20XX through 20XX. CFO worked as the Senior Vice President-Portfolio Finance and CFO for ORG from 20XX through 20XX.

The testimony of a forensic accountant, XXXXX XXXXXX, who has extensive experience, was summarized by the Bankruptcy Court as follows:

> XXXXXX concluded that CO-10 and ORG were effectively one entity and should be consolidated. He testified that the books and records of each entity were in terrible condition, that there was massive commingling of funds and that the accounting practices were "unusual" at best. He testified that reconciling several thousand transfers would be time consuming, expensive, and essentially impossible. He explained the reconciliation process requires that one look at the substance of a transaction over its form. That is to say, one must look beyond merely the recording of debits and credits in a transaction and analyze the purpose of a transfer in order to accord it proper characterization. According to XXXXXX, there were basically four purposes for the funds transferred into CO-10 and that were subsequently transferred out of CO-10. 1) The funds went back to ORG, 2) to President personally, 3) to pay bills on behalf of ORG, or 4) for "Ponzi"-like payments to investors in the ORG enterprise. XXXXXX concluded that President was carrying-on a Ponzi scheme; XXXXXX defined a Ponzi scheme as a "phony investment plan in which monies paid by later investors are used to pay artificially high returns to the initial investors, with the goal of attracting more investors." **(Exhibit 9,** p.11).

"XXXXXX concluded that [ORG] CO-10 and ORG [-EO] were effectively one entity and should be consolidated." **(Exhibit 9,** p.12).

The Bankruptcy Court, in its memorandum opinion concerning the dismissal or consolidation hearing for CO-10 and ORG, stated the following with respect to the relationship between CO-10 and ORG:

> In the few years prior to the bankruptcy filing, [ORG] CO-10 conducted no business operations and provided no goods or services from which a

receivable can arise. XXXXXX concluded that in excess, of $ million passed through [ORG] CO-10. It is naive to conclude that some discreet amount represents a receivable held by [ORG] CO-10 simply because a portion of the funds were ultimately spent by ORG [-EO] in some fashion. The Court accepts XXXXXX's basic conclusion that [ORG] CO-10 was nothing more than a conduit bank account. The Court likewise accepts XXXXXX's assessment that unraveling the funds that passed through [ORG] CO-10 is impossible".

(Exhibit 9, p.24)

The investors themselves stated in their proofs of claim filed with the Bankruptcy Court, "Investor-1 admitted at trial that President's scheme was designed as a fraudulent tax scheme and that he really could not defend it.." **(Exhibit 13A, p. 33, #107)**.
testified in bankruptcy court case, " concluded that the Investor-1 Deal was a transaction structured and papered as part of an abusive tax shelter transaction ..." **(Exhibit 13A, p. 30, #95)**.

Soft Money Partnerships or "Mirror Entities":

Prior to the purchase of one of the 65 housing communities, the Executive Director of ORG would form a partnership and identify all the general and limited partners to be involved. ORG was the general partner in all cases and owned a .001% or 1% interest in the partnership upon formation. Once the partnership was formed, an application would be submitted in an attempt to receive status as Low Income Housing by HUD standards in order to secure Low Income Housing Tax Credits. Upon approval, the limited partners would purchase their investments in the partnership and the funds would be used to rehabilitate the housing to bring it up to HUD standards.

In addition to these limited partnerships to obtain and rehabilitate the housing communities, the Executive Director of ORG also set-up soft money partnerships which appear to hold the same assets as the initial 65 housing community partnerships, and are denoted herein as "Mirror Entities." Funds received from the soft money investors were deposited into ORG CO-10 and were not transferred to ORG. Former Senior Vice President, former Senior Vice President of ORG, investigated the CO-10 bank records and determined that the Executive Director had set up this second set of partnerships, the "Mirror Entities" to facilitate payment of expenses during the setup phase of the initial limited partnership. Former Senior Vice President found that these "Mirror Entity" partnerships had no assets for collateral. Former Senior Vice President stated that she believed the soft-money investors were repaid through payment of the developer's fees and accelerated depreciation deductions generated by the "Mirror Entities."

The "Mirror Entities" would be tied to the legitimate entities only by the fact that money had been fronted by the soft-money investors to cover short term financing payments or other expenses incurred prior to securing long term financing. It was not determined if any other connection between the legitimate property partnership and the mirror entity other than the use of soft-money investor's funds to cover costs incurred during the short term financing period. Through CO-10 ORG received substantial funds from individuals and trusts acting as investors in these partnerships. There were between 62 and 86 of these "soft money limited partnerships" or "Mirror Entity" partnerships.

In most of the partnership agreements, President, guaranteed investment on loans provided within one year at 18% interest. President also had ORG guarantee the note.

Investors received benefit of millions of dollars in donations, non-recourse losses, and credits on their individual and business tax returns. They also received some return of capital or interest. ORG has less than 1% interest as General Partner in the Limited Partnership, CO-10; however, ORG controlled all the financial activities of CO-10.

Soft money limited partnerships or "Mirror Entities" received monies and deposited approximately 70 to 80% to CO-10. Disbursements were written from this CO-10 account with the majority of funds distributed to ORG, related entities, officers, and investors.

ORG Bankruptcy Proceeding:

President died on April 1, 20XX, 20 days before the bankruptcy petition was filed on April 21, 20XX, in a car crash that officials ruled a suicide. The death of President started a chain reaction of events. The circumstances of his death in a fiery automobile crash on an interstate highway outside City caused local creditors of ORG to become suspicious and begin an investigation into the financial affairs of President and ORG. These local creditors pooled their resources and hired the law firm of Law Firm-2 to file an involuntary bankruptcy petition on behalf of ORG. The involuntary petition was filed on April 21, 20XX, by the creditors who signed the petition (Petitioning Creditors).

The investigation revealed that President had transferred ownership of a number of ORG's assets to family trusts and foundations in the weeks before his death, including the right to receive the proceeds of $ million worth of key man life insurance policies. Upon this discovery, on May 18, 20XX, the Petitioning Creditors filed a lawsuit to recover these proceeds for the benefit of all ORG creditors. Certain members of ORG's management were replaced and ORG filed a voluntary petition in bankruptcy on June 11, 20XX. On that same date, a preliminary injunction was entered in favor of the Petitioning Creditors placing $ million of life insurance proceeds under the jurisdiction and control of the Bankruptcy Court.

After the filing of the involuntary bankruptcy petition, the CO-1 was formed. It consisted of four Petitioning Creditors and a representative from CO-1, a creditor that loaned monies to ORG. Since its creation, the CO-1 has met regularly to map strategy to recover the insurance proceeds and other assets for the ORG estate, and to develop a plan of reorganization that would ensure the largest possible recovery to creditors in the shortest period of time. The Trustee and the CO-1 believe that the Plan accomplishes these goals.

The Bankruptcy Plan creates a Liquidating Trust to take possession of the insurance proceeds and the other liquid assets of ORG in an attempt to preserve as much of these funds as possible for the benefit of the Creditors. It also provides for the certain properties it owns or controls – with the dual objectives of increasing revenues and profits that can be paid over to the Liquidating Trust and eventually paid to creditors, and also to avoid the creation of additional claims against the bankruptcy estate that would dilute the percentage paid to creditors who are the beneficiaries of the Liquidating Trust – for the period of time necessary to maximize value to the Estate. (See **Exhibit 2**)

Appointment of Trustee and President:

On April 28, 20XX, Trustee was appointed by the United States Trustee to serve as Chapter 11 Trustee in this case. The bankruptcy Plan, effective December 31, 20XX, appoints the Chapter 11 Trustee (Trustee) to serve as the Liquidating Trustee, whose responsibility will be to (i) take possession and/or control of various assets, including Life Insurance Proceeds, Causes of Action, and Miscellaneous Assets, that fund the Liquidating Trust and (ii) establish the number and amount of claims and then calculate and pay dividends to Creditors.

Further, the plan reconstitutes the board of directors with members who are experienced in running and managing a business similar in size and complexity as the business of the ORG as reorganized.

The Bankruptcy Plan appoints XXXX XXXXXX of XXXXX XXXXXXXX XXXX to serve as the president and chief executive officer of the Reorganized ORG who along with the reconstituted board of directors, will establish and follow a policy designed to maximize value to Creditors.

Per the Bankruptcy Plan, effective December 31, 20XX, Management of the Reorganized Debtor is described as follows, in part:

> XXXX XXXXXX will manage the Reorganized Debtor as its President and Chief Executive Officer. The President shall be responsible and report to the Reorganized ORG Board and see that the orders and resolutions of the Reorganized ORG Board are carried into effect. Subject to direction from the Reorganized ORG, the President will be responsible for administering the Plan on behalf of Reorganized ORG, including, without limitation, taking all appropriate actions to transfer the Trust Assets to the Liquidating Trust, and managing the future operations of Reorganized ORG. The President shall also have general supervision and control of the Reorganized Debtor's affairs and all of its business". (See Exhibit 2, pg 33, Art. VI, § 6.06)

XXXXX XXXXXXXX XXXX prepared a recommendation in its role assisting trustee Trustee who now runs the ORG Liquidating Trust. The recommendation suggests listing most of the company's 65 low-income housing properties scattered across the United States for sale by October 31, giving others to bondholders, and terminating all employees by the end of the year.

Objections to Bankruptcy Claims:

Claim of Investor-1:

In an adversary proceeding, the Bankruptcy Court found that the claim of soft money investor Investor-1 was disallowed as a "constructively fraudulent obligation" of ORG. (See **Exhibit 13(a),** p.2.) In reaching that ultimate conclusion, the Court also found that "Investor-1 was receiving credit for $ million in losses on an 'investment' of approximately $ million ... . (**Exhibit 13(a),** p. 33. ¶ 106). In addition, the Court found as a fact that "Investor-1 admitted at trial that President's scheme was designed as a fraudulent tax scheme and that he really could not defend it. His position is that he was simply taken along for the ride." (**Exhibit 13(a)**, p. 22, ¶ 107).

The Bankruptcy Court also found that President sent the following chart as an attachment to an email message on November 5, 20XX the day after a meeting with Investor-1 and his family members on November 4, 20XX, stating that the schedule reflects the proposed investment in CO-18,

EXHIBIT REMOVED

See **Exhibit 13(a)**, pp. 8-9.

Claims of Investor-3 and Investor-4:

Investor-3 and Investor-4 are additional examples of soft money investors who filed claims in the bankruptcy proceeding of ORG and to which the Chapter 11 Trustee for ORG objected on the grounds that the claims should be avoided as fraudulent obligations. See **Exhibit 14**, pp. 12-13 and **Exhibit 15,** pp.18-20.

Financial Status of ORG:

As a result of the review of financial documents of ORG and related entities, XXXX XXXXXX of the XXXXX XXXXXXXX XXXX summarized his conclusions as follows:

1. As of the end of 20XX, the end of 20XX, and the end of 20XX, ORG's Total Liabilities exceeded the value of its Total Assets which included its major assets, the CO-12 portfolio of apartment properties, CO-13 portfolio of apartment properties and the CO-14 portfolio apartment properties.

2. The Tax Credit Investments entered into during the time period 19XX through 20XX had extensive guaranty liabilities and obligations incurred through explicit guarantees of ORG executed by ORG at the inception of such Tax Credit Investments.

3. The assets of ORG with any material value were receivables owed to it by the Tax Credit Entities. The value of these receivables were limited (considerably less than face value), due to operational losses at several of these tax credit entities.

4. In addition, ORG had notes payable to various financial institutions during this period of time.

5. As a result of items one through four, above, ORG was insolvent during the period from December 31, 20XX, through December 31, 20XX.

See **Exhibit 2(a),** p. 2.

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer ORG	Tax Identification Number	Year/Period ended 20XX – 20XX

XXXX XXXXXX and XXXXX XXXXXXXX concluded in the report that ORG was insolvent from December 31, 20XX, through December 31, 20XX. The net equity of ORG was between a negative $ and $ million. (**Exhibit 2(a),** p. 12-13).

XXXXX XXXXXXX XXXXXXXXXXX (XXX) Loans to ORG:

CO-3 made three different loans to ORG in the total amount of $ as follows:

(1) Loan agreement dated April 17, 20XX in the amount of $ to ORG;
(2) Loan agreement dated April 17, 20XX in the amount of $ to ORG; and
(3) Loan agreement dated April 17, 20XX in the amount of $ to ORG.

See **Exhibit 16.**

The monies from these loans were distributed to CO-3 I, CO-3 II, and CO-3 III. ORG is 100% owner of all CO-3 entities. CO-3 entities were set up on April 4, 20XX. Officers of all CO-3 included President, President, Secretary and Controller, Secretary, and Controller. ORG board approved the loans. **(Exhibit 16(a))** The monies were deposited in separate partnership bank accounts and transferred in the accounts of ORG CO-10 and ORG. No partnerships returns were filed for CO-3 I, II, or III.

All amounts loaned to ORG were unsecured. ORG issued a guarantee of payment, but not of collection per the contract. Loan interest repayments were made through 20XX to XXX. Interest payments were the only repayment of such loans. The proceeds of the loan were intended to be used for the purchase of investment property.

A memorandum dated, February 20, 20XX, from President to Officer, Officer of CO-3, states as follows:

> The funds in each LLC were utilized to buy limited partnership interest [sic] in four apartment complexes ($), Series E Bonds on the Portfolio-1 Portfolio from CO-14 Housing Limited Partnership ($), and $ was paid to be Construction Company for pre-CO-10 cost at Apartments in City, State. These expenditures account for $ of the $ funds advanced. The remaining $ was transferred into CO-10 and used for various operating purposes."

See **Exhibit 16**.

Further, President states in the memorandum that the four City apartment complexes had sale agreements for a combined sales price of $.

An email dated August 26, 20XX, addressed from CFO, CFO, to Controller and (cc) to CPA-1 and CPA-2, CPAs and Auditors for Accounting Firm, and to President, indicates that monies from XXX were wired in various dates and amounts up to $. See **Exhibit 16(c)**.

Monies distributed from XXX were ostensibly paid to invest in the Partner-8, Partner-6, Pre-CO-10 and Portfolio-1 portfolio limited partnerships. In fact, monies were paid directly to soft-money investors in these limited partnerships. See **Exhibits 16(c), 16(d) and 16(e).**

EXHIBIT REMOVED

Although the partnership agreements reflect that ORG-X X, [redacted] a taxable entity, is the general partner of the ORG-XXX I, ORG-XXX II, and ORG-XXX III limited partnerships, ORG was listed on the Schedules K-1 as the general partner of these limited partnerships for both 20XX and 20XX. President directed how the amounts were to be booked. **Exhibit 16(c)**

The CO-3 limited partnerships did not maintain any books or records and did not have bank accounts during either 20XX or 20XX.

The loss amount listed on the ORG-X X, Inc's 20XX return line 7, Other income (loss), was labeled as coming from ORG-GCL CO-10. During the course of the examination the agent was unable to find an entity which matched this name; the ORG staff also was unable to identify the entity or property which matched this description.

Partnership-9 and Partnership-7 are some of the mirror entities that were set up by President. Partnership-9 was set up as a limited partnership in August 20XX. Its stated purpose appears to have been related to the residential rental activities associated with the ORG enterprise. The original partners in the XXXXX [redacted] were ORG-[redacted] Inc. (1% general partner), Partner 5 (42.5% limited partner), Investor-3(42.5% limited partner) and additional unnamed limited partners 14%. Partner-6 and Partner-5 each made capital contributions of $ in return for their ownership interests.

Partnership-9 appears to have amended the partnership agreement in 20XX when Partner-5 and Partner-6 assigned their ownership interests to CO-3 II a limited liability company wholly owned by ORG. (CO-3 II did not file a return for 20XX or 20XX)

The Schedules K-1 attached to Partnership-9's 20XX Form 1065, however, show that as of December 31, 20XX, ORG owned 1% as general partner and 99% as a limited partner. The 20XX Schedules K-1 also shows that Partner-5 and Partner-6 had no ownership in the Partnership-9 at the end of the year. No Schedule K-1 was located for either CO-3 II or ORG-[redacted] Inc.; it is unknown why these entities were not issued Schedules K-1 since partnership documents indicated they owned an interest in the Partnership-9.

On the 20XX Schedule K-1 issued by Partnership-9 to Partner-6 there were two entries, capital gain income and cash distributions. Partner-6 received a cash payment for the amount of his initial investment plus the exact amount of capital gain income reflected on the Schedule K-1. (Note: The cash distribution payment was issued to Partner-6 by CO-10, an entity that has been determined to be an alter ego of ORG. Partnership-9 did not have a bank account or funds from which it could have made any cash distributions during 20XX or 20XX.)

On the 20XX Schedule K-1 issued by Partnership-9 to Partner-5 there were again two entries: capital gain income and cash distributions. In this particular instance however, no actual cash was distributed to Partner-5; instead he received "credit" towards his investment in Partnership-7 (Note: Partnership-7 was determined to have been a partner in CO-10; Partner-5 included this "credit" as part of his proof of claim against CO-10)

In 20XX, Partnership-9 again amended the partnership agreement and ownership appears to have been assigned back to Partner-5 and Partner-6 from ORG-XXX on May 23, 20XX.

For 20XX four Schedules K-1 were attached to Partnership-9's Form 1065, one each to Partner-6 and Partner-5, one to ORG as general partner and one to ORG as limited partner; no other partner was issued a Schedule K-1 for this period.

The 20XX Schedules K-1 issued to Partner-6 and Partner-5 reflected an ordinary loss deduction of $ to each partner, no other amounts were listed. The 20XX Schedule K-1 issued to ORG reflected a $ ordinary loss deduction and a $ cash distribution.

Partnership-9's 20XX Schedule M-2 reflects capital contributions of $, $ from each individual partner, for this period. Since the Taxpayer did not have a bank account these capital contributions were deposited into the ORG CO-10 bank account.

ORG-[redacted] a "Mirror Entity" was listed on the partnership agreement as the general partner for both 20XX and 20XX; this entity has not filed a return with the IRS since its inception in 20XX. While it is understood that this corporation was created by President for use within the ORG entity structure, its exact purpose with respect to this ORG was unknown.

It was also unknown why the partnership agreement listed ORG-[redacted], a taxable entity, as the general partner while ORG was listed on the Schedule K-1 for both 20XX and 20XX as the general partner.

ORG-[redacted]did not maintain any books or records and did not have a bank account during either 20XX or 20XX.

The function and purpose of "Mirror Entity" was similar to that of Partnership-9. Both were set-up by President and owned 100% by ORG. Both received monies through ORG CO-10. Neither had books and records, assets, or a bank account.

Partnership-10:

The Partnership-10, Limited Partnership has many facts in common with those described above. Individuals who were family related members (M-Trust) were to receive $ from sale of land from their trust to an individual. They transferred their interest into a "mirror entity" partnership, Partnership-11, with the hopes of receiving tax abatement on their capital gain through a series of structuring loan documents and ownership with ORG and its other ORG related entities (ORG and Construction Company) to increase basis (non-recourse note), thereby reducing their capital gain. Proceeds from the sale were delivered to ORG, and the individuals received interest in a "mirror entity", Partnership-10 which had no assets. ORG used the monies received for other uses of ORG and payments to other soft-money investors. See **Exhibit 16(e)**.

The amounts received from the sale of the Ranch were not reported on any partnership or K-1 return or by Partnership 10. It was determined that a gain of $ should have been reported.

ORG orchestrated the scheme through borrowed or invested monies used from soft money investors ostensibly for the purposes of purchasing, improving, or selling property; the funds from the soft money investors were actually used to pay back other soft money investors from other previous loans, investments, or interests in "mirror entities". As historically patterned, Partnership-10 filed no returns to show gain from sale of property and had no assets, no operations, no bank accounts, no substantive services performed, no bidding or speculative business rendered for monies received.

Foundation, formerly Corporation (CORP):

Foundation was incorporated in the State of State August 25, 19XX as CO-19. One of its listed charitable activities was "[t]o increase the availability of financing and grants for affordable community housing and CO-10 activities and projects that benefit low-and-moderate income persons in County, ." The organization applied for exempt status on September 14, 20XX, it was recognized as an organization described in section 501(c)(3), by letter dated November 22, 20XX.

On February 18, 20XX, the name of the organization was changed to CO-19. On September 28, 20XX, the organization's name changed again to Foundation.

CORP provided property construction and repair for all of ORG's housing units. CORP was operated by President of CORP, son-in-law of President, President of ORG. The boards of both entities met together during most of their general meetings. ORG officers commingled use of CORP's bank accounts; the approving of payments, jobs worked, and estimates on repairs were conducted by CORP but approved by ORG. The Controller of ORG maintained the use of the bank account of CORP; she withdrew monies from the account of CORP and transferred them to ORG via wire. Further, the accounting system for CORP used QuickBooks and was maintained by the Controller of ORG.

President of CORP, served as the President of CORP until October of 20XX. CORP provided construction, repair, and maintenance services to ORG. Over 90% of the business activities transacted by CORP were with ORG and its related entities. CORP entered into various construction and repair contracts as a result of damage to ORG properties due to hurricanes, water damages caused by hail and flooding, fires, and other insurable claims. Monies from insurance proceeds were paid from CO-10. The contracts were with ORG, however, rather than CO-10.

CORP's reported revenues went from a low in 20 of $ to a high in 20XX of $ and were $ in 20XX. For the years 20XX through 20XX, CORP reported on its Form 990 under "Other Note and Loan Receivables" amounts that it described as "N/R from" or CO-10 fees from nine related entities of ORG for a total of $. **(Exhibit 17)**. When asked about these amounts, President of CORP stated that they were "booked" by CORP before he became president and that he believes that the amounts were parked on CORP's books from ORG to claim additional cost in connection with housing credits. He stated that there was a corresponding liability posted to the books; however, these liabilities changed from year to year in amounts and accounts. President of CORP and BOD-9 stated that the amounts were written off the books in late 20XX or early 20 ,as they had no value, they were offsetting amounts, and they did not affect the organization. The amounts were uncollectible; XXXX XXXXXX testified such amounts were not receivable and should not be included in ORG's books. **(Exhibit 2(a), p. 10/11)**

Apartments-1, owned by ORG, were located in City, State as a low income housing complex. During the years ended December 31, 20XX through 20XX, the complex suffered extreme damage and was later designated as in the flood plain by FEMA. FEMA insured the property. During the year 20XX, flood damages caused damages resulting in a claim for $. See **Exhibit 18(a).** The claim was based on written estimates provided by President of CORP of CORP for approval of construction and rehabilitation work. During the same year, Controller, serving as Controller for ORG, withdrew $ twice from the Apartments-1 proceeds from CORP bank account to deposit in the ORG account. Controller stated the following an email message dated, October 30, 20XX, to President of CORP: "President had me take another $ from Apartments-1 today. I have recorded everything in QB for you." See **Exhibit 18(b).**

This money was not replaced in the project. There was no evidence provided to indicate the work was ever completed. This incident indicates the level of control, President, as President of ORG, exercised over related entities such as CORP in that monies received by related entities for specific purposes were used for other finance purposes of ORG.

<u>Fire Loss at Apartments-2 owned by ORG in City, State:</u>

On February 9, 20XX, a building containing 16 low-income rental units was fire damaged. The building was not replaced nor was any portion of the ORG City LLC Bonds redeemed. The acquisition of the property was made through the bond proceeds. The bond proceeds were used to purchase the three apartment complexes in . These properties were collateral for the bonds. The Apartments-2 fire converted the 16 units of collateral into net insurance proceeds of $, which is also collateral for the bonds. The 16 units were not rebuilt nor were any of the bonds redeemed with the insurance proceeds. This was a material event, reportable to the bondholders under SEC rules. ORG failed to issue such report, which could have triggered some of ORG's guarantees to the investors.

The $ in insurance proceeds was paid to and deposited into CORP's bank account. Only $ was paid by CORP for the demolition of the 16 destroyed units. CORP billed ORG the amount of $ for this demolition. The amount of $ was used to pay a soft money investor (Partner-4 Trust). In short, only $ could be deemed a proper use of the proceeds. The amount of $ is a diversion of collateral as to the bondholders and is considered bad use under section 145.

The insurance claim was paid from Specialty Insurance Company, as follows:

Whole Loss on Property	$	
Less Depreciation	( )	
Less Deductible	( )	
Net Insurance Proceeds	$ -	Insurance paid to ORG

The $ was deposited into CORP's account; CORP served as a general contractor on July 9, 20XX. The amount of $ was paid to ORG CO-10 from CORP. The amount of $ was returned to CORP from ORG and was reported as a wash entry.

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS		Schedule number or exhibit
Name of taxpayer ORG		Tax Identification Number	Year/Period ended 20XX – 20XX

Date	Amount	Description
7-27-XX	$	transferred to Partner-4 Trust attributed to Apartments-3 – CO-12 (soft money)
8-20-XX		Property Management (Property Mgt) for Apartments-4
8-20-XX		Property Management (Property Mgt) for Apartments-5
8-20-XX		Property Management (Property Mgt) for Apartments-6
8-20-XX		Bank Fees
2-16-XX	$	Mid-Continent for demolition Billing
11-29-XX	$	Mid-Continent for demolition
11-6-XX	$	Mid-Continent for demolition
	$	Unaccounted Insurance proceeds
	$	Net Insurance proceeds not spent on Apartments-2 Rehab

Apartments-2 still shows no change in the number of low-income units even after one of the 16 unit apartments had been destroyed. Instead of rehabilitating the units CORP demolished them. Although, the demolition billings were excessive; an invoice shows the actual demolition costs for the destroyed building was $ billed by CO-20. Project Manager was project manager. Completion of work had to be no later than October 17, 20XX. billed CORP on October 14, 20XX. CORP check number dated November 7, 20XX, was paid to . (**Exhibit 19**). CORP billed the much higher cost to ORG as stated in Controllers's summary. On August 2, 20XX, CORP sent $ back to ORG and $ to the Partner-4 Trust fund on July 27, 20XX. (**Exhibit 20**). The total disbursed by CORP equals the total billed ($ + $ = $); CORP provided questionable billings in order for ORG to qualify for the insurance proceeds. No rehabilitation was conducted and the demolition was performed for substantially less than the insurance billings.

There should be a recapture in credits for 20XX, 20XX, 20XX pertaining to credits taken on this property. Apartments-2 was to provide housing in order to qualify for the tax credits.

Other Activities of CORP:

As stated previously, operations of CORP were managed with oversight by ORG. CORP also had interest in the following through ORG:

- CO-21 (Address, City,)
- Partnership-11 (Address, City,)

Partnership-11 owned 100% of XXX XXXXXX, (**Exhibits 21(a), (b), (c)**, and **(d)**). The Form 1065 for 20XX of CO-21 shows assets of $, mortgage liability of $, other liabilities of $, and partner's capital of $. (**Exhibit 21(e)**). CORP owned a 1% interest in Partnership-11 as the general partner through the 100% interest in XX-XXX XXX XXXXXX President of CORP is the registered agent. President signed and prepared all CO-21 and Partnership-11 20XX and 20XX returns.

The 20XX Form 1065 tax return for Partnership-11 per K-1 shows capital contribution by CO-22 and net income loss distributive to partners in the amount of - $. (**Exhibit 22**). The K-1 also reflects other deductions (loss) in the amount of ($) and capital gain of $.

The 20XX return for Partnership-11 provides a K-1 showing ORG - EO as recipient of the CO-22 interest of 99.90%. The donor per Form 8283 is CO-21. (**Exhibit 23**). The Form 8283 was signed by President as President of ORG as donee and as appraiser indicating the donor's cost of $ and donation of $ on December 31, 20XX. The appraised value of the property as of February 29, 20XX pursuant to the appraisal signed by Appraiser, was $. See **Exhibit 24(a).**

Partnership-11 filed Form 1065 for 20XX reflecting Line 9 assets in the amount of $. Liability is indicated in the amount of $, which consists of a note of $ from CO-22 to CORP and $ from . (**Exhibit 22**, p. 16). The Deed of Trust and Security Agreement, however, indicates that loan and property were acquired on December 31, 20XX by CO-21, rather than by CORP, with a note in the amount of $. (**Exhibit 25**). The loan terms were for one year. This same note was extended on December 31, 20XX. (**Exhibit 26**).

CO-22 initially acquired property in foreclosure located at Address, City, State. The property was reacquired by CO-22 on September 7, 20XX, in a short sale for $. See **Exhibits 27** and **28**. It is unknown how Partnership-11 acquired the property. While Form 8283 shows the donee as ORG, no transfer of the deed has been provided. Further, there is no evidence that a Form 8282 was filed reflecting a transfer of property from ORG to CO-21. See **Exhibit 24(b).**

The Form 990 for 20XX filed by Housing Foundation, an entity operated by ORG, reflects a public donation of $ from CORP. The property description is "Address, City, State (5.193 Acres and 109 room Motel) - Bargain Sale."

President's Son, son of President, made the following announcement to the board of ORG and CORP on August 1, 20XX:

> City, as discussed in the previous board meeting, we have purchased an old Inn in XXX XXXXXX. We are going to be, in the next few months, looking at doing a tax credit project on that property, but as of right now, we've got the property and we're looking at our plans and options of what we are going to do and how we are going to move forward on that project.

Exhibit 30, p. 30

<u>Following are notes with respect to an interview by agents with President of CORP on September 22, 20XX:</u>

> Per President of CORP, President purchased a hotel in XXX XXXXXX to turn it into a Senior Citizen's place. CORP did a scope of work. CORP took out a loan with CO-22 for $. This loan was never repaid and the property was foreclosed upon. Property was owned by CO-22. CO-22 foreclosed on the loan as a result of lack of action and basically received property back that it initially owned. Under the banking rules the time period for owning property was exceeding and that is the reason the circumvention of the rules to distribute property that they intended to keep. After the two year holding period expired and no work performed to rehab or make payments upon supposed debt, the property was then returned back to

the initial owner, CO-22. President of CORP stated that he signed the note as CO-22. It was a non-recourse note.

President of CORP stated in the interview that he was unaware of transactions, although his company participated in the valuation, ownership, and ultimate increase in value that benefitted donors.

Appraiser provided an appraisal of the property at Address, City, State, that was formerly known as Inn and Suites. The appraised value pursuant to that appraisal, as noted above, is $; the projected sales price was $. The adjusted value of the donation was $. (**Exhibit 24**).

Following is an excerpt from the appraisal:

> Based on the income and expense statements provided to this appraiser and **assuming that all of the proposed remodeling is completed in a workmanship-like-manner and according to the proposed plans and specifications and assuming that the units are leased according to the proposed rent schedules**, it is this appraiser's opinion that the **Potential** Market Value for the subject, as of February 29, 20XX is: ($). (**Exhibit 24(a)** emphasis added).

The appraisal was based on future work and future rental rather than the fair market value at the time of the appraisal. CO-22 ultimately received the same property back without harm or risk.

Initially, the property is shown as donated by CORP to Housing Foundation on 20XX. Further, the same asset is to have been included on the return of Partnership-11. and LLC. The appraisal was completed on March 3, 20XX. The property is reflected as being donated by Partnership-11. to ORG. There was no verification that the deed was ever acquired by CORP or ORG and property was returned without any financial transactions to the original owner within three years. CO-22 transferred the property to Partnership-11., and county records show no other transfer or sale of the property until Herring reacquired it on September 7, 20XX.

Overall Pattern of Operations:

President caused ORG to form many partnerships throughout 20XX through 20XX, in which ORG promised a guaranteed rate of return, a return of principal invested, a portion of any ultimate profit, and the ability to deduct operating losses. He apparently commingled funds invested and diverted substantial sums for unrelated purposes. He executed non-recourse notes on behalf of the partnerships payable to ORG. The aggregate original balances of the notes were approximately equal to the operating losses allocated to the partnerships.

In the case of fire loss insurance proceeds for the Apartment, the proceeds, for the most part, were not used to restore the property. The inflated appraised value of the Inn in XXX XXXXXX was apparently used to provide the purported donor with an increased charitable deduction. The same property appears to have been donated by several entities, and the initial donor retains ownership afterward.

ORG, through the actions of its President, appeared to be engaged in an overall pattern of deceptive financing practices and tax avoidance plans during the years examined.

Payments to or on Behalf of President:

Form 990 for 20XX (Exhibit 0-1) indicated a loan from President President to ORG in the amount of $. By year end, $ was purportedly due, and this amount was purportedly paid in full in 20XX. See **Exhibit 0-2**

TABLE DELETED

Although the Form 990 indicates amounts for a loan to the officer with stated interest, no notes were provided to the agent. In Information and Document Request 21, the agent requested all known notes, loans or transactions between President and the organization, ORG. See **Exhibit 36**

When the agent asked Senior Vice President, Senior Vice President of AH-EO on October 13, 20XX, whether he had seen a note to President for monies owed him by ORG, CFO responded that he never saw a note and that President had an agreement and note in place before he was hired. See **Exhibit 12**, p. 3.

For the years 20XX, 20XX, and 20XX President received substantial amounts of monies from ORG and various related entities. See **Exhibit 31.**

The officer had received funds from various ORG accounts since 19XX. Payments to the officer were classified as repayment of an outstanding loan from ORG CO-10, ORG Management, and ORG accounts. Occasionally, President would also deposit monies back into the account from his personal account, trust account, and other personal accounts. Most of the deposits were wired.

Amounts received by President were not included in his Forms W-2, shown on an information return as other income (1099-misc), or included in any partnership returns, or on a Form K-1. The disbursements received were treated as a repayment of a loan. No amounts were classified as interest income. No board approvals of additional disbursements to President were provided.

Following is an excerpt from notes with respect to an interview of prior Controller Controller:

> "Payments to President were booked as a repayment of loan (Per acct [numbers redacted]). President directed as Controller to apply amounts received by him as a repayment of loan. Previous to Controller's

employment with ORG amounts were treated as a payable on loans due to officer. Controller is unaware of any note for a loan due to officer and particularly to President. Amounts received by President for loan repayments were not included in a Form W-2 or Form 1099".

Exhibit 32, p. 1.

It appears that President as President directed funds to himself for his own personal benefit. In addition, President used the corporate American Express Credit Card for his personal benefit which included paying for travel, vacations, meals, hotels, household items, clothing and gifts. No evidence of reimbursements to ORG for such amounts has been provided; the amounts received were not included in Forms W-2 or Forms 1099. For the year ended December 31, 20XX and December 31, 20XX, he received payments and American Express Charge personal benefits in the amounts of $ and $, respectively. **Exhibit 31(a) through (j).**

TABLE DELETED

No loan documents were provided. The transactions for actual payments received and American Express charges paid on behalf of the officer were not listed on the Form 990. No loan interest was reported on the Form 990. No payment of interest was documented. Distributions occurred since 20XX, and the balance appeared to increase with additional disbursements received; there is some indication of repayment or transfer of monies from the officer to the organization. It does not appear that President pledged any collateral for a loan, and there is no evidence that there was any demand for payment for the loan. Although there were several business dealings involving bank, commercial, and bond financing and hundreds of partnership agreements, as well as loans and the loan documents to third-party investors, there is no evidence of any loan documentation on unsubstantiated disbursements provided to President.

At President's direction, amounts paid to him or on his behalf were characterized as loan repayments. The amounts determined by CPA firm's auditors were less than the amounts determined by examination. ORG has not provided an explanation to indicate the large variance in amounts per the return and the records.

President, did not manage or operate ORG as directed by its Bylaws and Conflicts of Interest Policy for Board Members and Officers which clearly states that the corporation shall not fail to disclose corporate opportunities for an officer or employee, receive personal benefits, receive unsecured loans, favors, and self-dealing or inurement as stated below:

A. "Compensation includes direct and indirect remuneration as well as gifts of nominal value or favors that are substantial in nature.

B. Corporate Opportunity. It may be a conflict of interest when a board member or officer fails to inform the Corporation of a corporate opportunity and instead diverts it to himself or herself (or immediate family member) to the detriment of the corporation. The opportunity must be in a line of

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer ORG	Tax Identification Number	Year/Period ended 20XX – 20XX

business similar to those the Corporation currently operates and must be one that could be advantageous to the Corporation.

C. Nonpublic Inside Information. It is a conflict of interest to disclose nonpublic inside information relating to the Corporation and/or any of its Affiliates' business and/or use such information for the personal profit or advantage of any board member or officer, his or her immediate family, or any other entity of which the board member or officer is an employee, officer, director or shareholder.

D. Gifts, Gratuities and Entertainment. It may be a conflict of interest for a board member or officer (or immediate family member) to accept gifts of nominal value, excessive entertainment, unsecured loans or other favors from any outside concern that does, or is seeking to do, business with, or is a competitor of, the Corporation and/or any of its Affiliates under circumstances from which it might be inferred that such action was intended to influence or possibly would influence the board member or officer in the performance of his or her duties.

E. Other Areas of Conflicting Interest. Other circumstances may arise which could result in a conflict between a board member's or officer's personal interests and those of the Corporation. These Policy guidelines are not intended to describe all potential conflict situations. In general, any circumstance that may give rise to reasonable questions of possible favoritism, self-dealing or undue influence may be a conflict of interest. All such conflicts should be avoided, if possible. The Corporation's board members and officers should also be sensitive to the appearance of conflict, even if no actual conflict exists. If an actual or possible conflict cannot be avoided, it shall be disclosed according to the procedures set forth in Article IV of this Policy."

Exhibit 33 , section III. A/B

Further the conflicts of interest section with respect to loans stipulates as follows: "The Corporation is prohibited from lending money to or guaranteeing the obligation of any board member or officer". **Exhibit 33,** section VI

As stated previously, no evidence of a note was provided. There were no board approvals for such loans. There is no defined period for repayment or any interest accrued. President did not enforce the collection of the supposed loan; he merely extended it. President appeared to repay some of the monies while consistently receiving additional funds as loans, which increased the year end balance due each year. The unpaid amounts from 19XX through 20XX totaled $. In 20XX, President received an additional $ from ORG. In total, the amount from cash disbursements and payment of personal expenses appears to be $, from 19XX through 20XX

Cash paid directly to President and payments of personal expenditures for him from the corporate American Express card, shows that he received hundreds of thousands of dollars for his personal benefit.

TABLE Deleted

For the periods ended December 31, 20XX, 20XX, and 20XX, President received $, $ and $, respectively, from ORG and its related entities.

During the ORG bankruptcy proceeding, it was disclosed that President caused the proceeds of the key man life insurance policies on his life by ORG and other ORG assets to be transferred to his family's trusts.

LAW:

Must Operate Exclusively For Exempt Purposes

Internal Revenue Code section 501(c)(3) describes organizations exempt under this code section as follows:

> 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.

Treasury Regulation section 1.501(c)(3)-1(c)(1) provides that "[a]n 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."

Treasury Regulation section 1.501(c)(3)-1(c)(2) provides that "[a]n 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." "The words 'private shareholder or individual' in section 501 refer to persons having a personal and private interest in the activities of the organization." Treas. Reg. § 1.501(a)-1(c).

Treasury Regulation section 1.501(c)(3)-1(d)(1) states that in general:

> (ii) An organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary

for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

(iii) Since each of the purposes specified in subdivision (i) of this subparagraph is an exempt purpose in itself, an organization may be exempt if it is organized and operated exclusively for any one or more of such purposes. If, in fact, an organization is organized and operated exclusively for an exempt purpose or purposes, exemption will be granted to such an organization regardless of the purpose or purposes specified in its application for exemption. For example, if an organization claims exemption on the ground that it is "educational", exemption will not be denied if, in fact, it is "charitable".

In Better Business Bureau v. United States, 326 U.S. 279 (1945), the Supreme Court held that regardless of the number of truly exempt purposes, the presence of a single substantial non-exempt purpose will preclude exemption under section 501(c)(3) of the Code. See also American Campaign Academy v. Commissioner, 92 T.C. 1053, 1065-66 (1989) (when an organization operates for the benefit of private interests, such as designated individuals, the creator or his family, or persons directly or indirectly controlled by such private interests, the organization by definition does not operate exclusively for exempt purposes); and Old Dominion Box Co., Inc. v. United States, 477 F.2d 340 (4th Cir. 1973) (operating for the benefit of private parties who are not members of a charitable class constitutes a substantial nonexempt purpose.)

In Founding Church of Scientology v. United States., 412 F. 2d 1197 (Ct. Cl. 1969), the court stated that loans to an organization's founder or substantial contributor can constitute inurement that is prohibited under section 501(c)(3). In that case, the church made loans to its founder and his family and failed to produce documentation that demonstrated that the loans were advantageous to the church. The church also failed to produce documentation to show that the loans were repaid. Significantly, the court stated that "the very existence of private source of loan credit from an organization's earnings may itself amount to inurement of benefit."

In Leon A. Beeghly Fund v. Commissioner, 35 T.C. 490, 518 (1960), aff'd, 310 F.2d 756 (6th Cir. 1962), the Tax Court stated:

> We think that although the ultimate purpose of the trust to benefit charities may have remained unchanged by this transaction, nevertheless, the primary objective of the trust entering into this transaction was for the benefit of stockholders of [the business company] with the objective of ultimately benefiting charities running a poor second, and that when the trust was utilized for such a purpose it fell without the scope of both the language of section 101(6) [now Code §501(c)(3)] and the congressional intent in enacting this exemption provision.

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

In Revenue Ruling 67-5, 1967-1 C.B. 123, it was held that a foundation controlled by the creator's family was operated to enable the creator and his family to engage in financial activities which were beneficial to them, but detrimental to the foundation. It was held that the foundation was operated for a substantial non-exempt purpose and served the private interests of the creator and his family, and therefore was not entitled to exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code.

In Kenner v Commissioner, 318 F2d 632, (7th Cir. 1963) ; the court determined that the founder commingled his own personal funds and the funds of the hospital in the latter's bank accounts and that no systematic records of any sort were kept by the hospital. The founder withdrew from the hospital's bank account thousands of dollars, to pay for his personal and farm expenses, as well as his liquor bills, gasoline bills, and the expenses of his personal residence. The court rejected the founder's contention that his withdrawals from the hospital funds were limited to funds which he had previously lent the hospital, finding that these loans were merely CO-10s by which the founder used the hospital's bank accounts to drain off hospital funds to pay his personal expenses.

Elements of a Loan

In Haag v. Commissioner, 88 T.C. 604, 615 (1987), aff'd without published opinion, 855 F.2d 855 (8th Cir. 1988), and Beaver v. Commissioner, 55 T.C. 85, 91 (1970) the elements of a bone fide loan are discussed. The cases emphasize that the recipient must intend to repay the amounts and the transferor must intend to enforce payment.

The Tax Court in Dean v. Commissioner, 57 T.C. 32, 43 (1971), held that the determination of whether a transfer is a loan is not based on a single factor, standing alone: each factor is considered with all the facts and circumstances present.

In Vinikoor v. Commissioner, T.C. Memo. 1998-152, the Tax Court states as follows:

> The determination of whether a transfer was made with a real expectation of repayment and an intention to enforce the debt depends on all the facts and circumstances including whether:
>
> (1) There was a promissory note or other evidence of indebtedness;
> (2) Interest was charged;
> (3) There was security or collateral;
> (4) There was a fixed maturity date;
> (5) A demand for repayment was made;
> (6) Any actual repayment was made;
> (7) The transferee had the ability to repay;
> (8) Any records maintained by the transferor and/or the transferee reflected the transaction as a loan; and
> (9) The manner in which the transaction was reported for Federal tax purposes is consistent with a loan.

Taxpayer's Position:

The organization has not confirmed a position at this time.

ANALYSIS:

Exempt Purpose Activities:

ORG operated low-income housing properties and served an exempt purpose in so doing. In addition, it provided such services at its housing communities as operating neighborhood learning centers through a HUD initiative with GED classes, computer classes, life skills classes, parenting classes, substance abuse prevention presentations, employment readiness classes, and cultural exchange nights.

Non-exempt Purpose Activities:

ORG also operated to enable various arrangements for some investors to receive high rates of returns and generate large deductions and losses. For later investors, the promised returns were not materialized. The Bankruptcy Court described one scheme facilitated by ORG as an "effort to obtain [an] improper tax benefit." See **Exhibit 13(a)**, p. 43, ¶8.
The non-exempt purpose activity of ORG was substantial; as noted in Better Business Bureau v United States, supra, a single non-exempt purpose, if substantial, will preclude exemption under section 501(c)(3).

The schemes directed by the President caused the assets of a huge organization to be drained such that they were no longer available for exempt purpose activities. See **Exhibit 2(a),** p. 2. Although ORG provided low income housing, more than an insubstantial portion of its activities were directed to the benefit of private individuals and was a camouflage to the many non-charitable activities conducted by the officer.

CO-10

President created CO-10 using cash from soft-money investors and donations to inflate the values of assets, as a source of funds for ORG, and to receive monies as an improper tax scheme. CO-10 funds were transferred for four basic purposes: 1) to create an "off the book" entity that could be used to cover-up cash-flow deficiencies within the ORG enterprises, 2) obtain loans and investments under the ORG CO-10 name in order to avoid negatively impacting the ORG Balance Sheet, 3) to receive and disburse investor funds while also serving as the source of the tax deductions/losses promised to the various investors, and 4) receipt of personal benefits and monies recharacterized as payment of business expenditures and loans payable to President as an officer. (See CO-10 section under Facts.)

Regulation section 1.501(c)(3)-1(d)(ii) states that a 501(c)(3) organization must serve a public rather than a private purpose and it is necessary for the organization to show that it is not operated for the benefit of private interests such as the creator. The operation of CO-

10 appeared to further the private interests of the creator and third party investors rather than to further a public charitable purpose.

Soft Money Investors/Partnerships:

The court appointed trustee for ORG, Trustee, filed numerous objections to claims of the soft money investors. The Bankruptcy Court concluded that claims such as that filed by Investor-1 were disallowed pursuant to Section 548(a)(1)(B) of the Bankruptcy Code as constructively fraudulent obligations of ORG.

A finding of fact in the adversarial proceeding in the bankruptcy case indicates the relationship of the soft money investors to the President of ORG, President and ORG's involvement in the soft-money investor matters:

> Investor-1 and Investor-2 [Investor-1's office assistant] both admitted that in retrospect, the Investor-1 Deal, when coupled with the information concerning the pass-through losses flowing from to and ultimately to Investor-1, constituted an illegitimate or improper tax scheme orchestrated by President. (**Exhibit 13(a),** p. 22, ¶67).

The Bankruptcy Court also found the following in that proceeding:

> ORG is an asserted non-profit entity and thus has no shareholder involvement. There is no evidence that ORG's board exercised any control over President or that it ever monitored the transactions of ORG. ORG was a participant in the Investor-1 Deal and thus significantly contributed to the effort to obtain the improper tax benefit for Investor-1. Investor-1 said he was investing in President's "housing fund." **Exhibit 13(a),** p. 43, ¶8

Further the court stated,"[T]he scheme here is a tax scheme. The evidence establishes that the refund sought was illegitimate." **Exhibit 13(a),** p. 44, ¶10

Unlike the organization described in Revenue Ruling 68-71, supra, where the benefits to private interests were found to be quantitatively incidental and insubstantial in amount, the benefits conferred on some investors in related limited partnerships of ORG were substantial and drained the resources of ORG. More like the organization described in Revenue Ruling 76-152, supra, formed to promote community understanding of modern art trends that conducted an art sales activity that provided artists with direct monetary benefits and enhanced their careers, provided a substantial benefit, ORG provided benefits that were quantitatively substantial to some investors. ORG used the employees of ORG to prepare and construct loan documents of shell entities, and generate mirror entities to obtain improper tax benefits.

Because ORG provides a substantial private benefit which is not qualitatively or quantitatively incidental to its exempt purposes, ORG has failed the operational test set forth in section 1.501(c)(3)-1(c)(1) of the regulations.

Insolvency:

The methods and manners in which operations were conducted were not standard business practices for an exempt organization in the low-income housing business. Methods employed did not serve a charitable purpose, but rather led to the dysfunctional business practices which guided the organization to insolvency.

> In his expert report, "concludes that as of December 31, 20XX, shortly after the Investor-1 deal, ORG [-EO} had total assets valued at $ and total liabilities of $. The total liabilities include claims arising from guaranties issued by ORG [-EO] in connection with seventeen tax credit properties, which ORG [-EO] or an ORG-affiliated entity served as a general partner in limited partnerships and typically owned approximately a 1% interest."

Exhibit 13(a), p. 33, ¶ 109

The Bankruptcy Court concluded that ORG was insolvent. (See **Exhibit 13(a)**, p. 34, ¶ 111). It appears the certified annual reports of ORG did not reflect the true assets and liabilities of ORG. A comparison of the face value to the total value of the assets revealed a large variance of around $ in the true value of the assets owned by ORG for years 20XX, 20XX and 20XX. **Exhibit 2(a),** p. 10-11

See summary below:

Table Deleted

The variance in the amounts reported and the value of the assets shows again an overstatement of the assets value per expert testimony of XXXX XXXXXX. Assets largely were uncollectible amounts owed from the related partnerships and Tax Credit properties that were unprofitable, some of which have been foreclosed upon. Secondly, ORG shows large note receivables for Developer Fees over $ which was uncollectible due to being obligations of the aforementioned unprofitable partnerships. The partnership agreements stipulate the Developer Fees and contain a provision that, if not paid within the tenth anniversary of the partnership's respective property placed in service, then the general partnership (ORG or ORG Affiliate) is required to contribute the sum of money needed to allow the respective partnership to pay the Developer's Fee. Basically, then it becomes a non-asset as it would be offset by the corresponding liability owed to ORG or ORG Affiliate (ORG would owe itself). Last, there is no history of ORG receiving Developer Fees; therefore, the receivable should never have been included in income. The over stated receivables were not presented in the certified audit report, and, therefore, the gross values were included in the report. The returns were filed without mention or notation.

The actions of the President of ORG to make large guarantees of investment profit to limited partners and guaranteed loan repayment of others' obligations in the face of the insolvency of an organization indicate poor management of the resources of the exempt organization and a use of its assets for nonexempt purposes.

CO-2:

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ORG received a non-collateral loan in the amount of $. The board of ORG approved the granting of the loan. While the monies were represented to be for the use of low-income property needs, the proceeds were used to payoff soft-money investors through the creation of other entities including the following: CO-3 I Partnership-9, CO-3 II Partnership-7, CO-3 III Partnership-7, CO-3 I Partnership-7, CO-3 I Pre-CO-10, CO-3 I Series E Bonds and others. The partnership agreements listed both ORG and other entities as the general partners. President, President, directed the control and flow of funds.

The CO-2 loan is a substantial loan used by ORG for non-exempt purposes. The created entities had no assets, no bank accounts, and no operations and were similar in name to partnerships that did have assets to give the appearance of an exempt low income housing property partnership. ORG orchestrated a maze of entities to provide monies to the soft money investors. Funds were borrowed from s by ORG to meet the obligations to soft money investors and were a private benefit to those investors.

ORG has not documented that any exempt function was met in the use of the loan proceeds. Funding an investment scheme does not further an exempt purpose for an organization described in IRC Section 501(c) (3).

CORP:

Corporation (CORP) later changed its name to Foundation and was closely related to ORG through the business practices and its operations. The manner in which it operated was through the "ORG Enterprise". Construction duties performed were strictly for ORG and its related organizations. The board functions of CORP were held with the board meetings of ORG. President of CORP, CORP President, was a son-in-law to President. He was also an employee of ORG. Accounting services and records were conducted through ORG.

It appears that CORP was used to enable inflated asset building by ORG. Uncollectible revenues were booked on CORP records in the amount of $ for supposed deferred revenues to ORG. In essence, the deferred revenue was uncollectible and should not have been booked. In this case as in Petzoldt v. Commissioner, 92 T.C. 490,518 (1960), the failure to adequately keep the required books and records, therefore, requires the respondent to reconstruct income per IRC section 446. In this case the improper recording of deferred revenue increased the value of the assets and liabilities. The ultimate intent to overstate values was to create an opportunity for additional loan leveraging and credit qualification.

Spinoff entities through XX-XXX for CO-21 and Partnership-11 were created for non-exempt purposes. Additional spinoff companies were formed with ORG maintaining a similar role as the general partner. The acquiring of the hotel property from CO-22 was served non-exempt purposes. CO-21 shows its only asset for 20XX as being the in City valued at $. The liability reflected was $, which appears to be the amount owed CO-22. It appears that CO-22, through an entity created by President has or created basis of $. In 20XX, ORG is shown as a recipient of donated property (from Partnership-11), when in essence the donor is indicated as XXX XXXXXX, In this period the donor's cost is indicated at $. CO-22 is attributed as making a donation of $ as a 99.90% owner. The appraisal was completed in 20XX, and the Potential Market Value is stated at $.

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS		Schedule number or exhibit
Name of taxpayer ORG		Tax Identification Number	Year/Period ended 20XX – 20XX

The agent's review indicates that several investors received benefit from this transaction, per flowchart (**Exhibit 21(a)** and **22**) from the acquiring of the property through inflated appraisal and a charitable deduction of over $ in which the CO-22 was the recipient. Further, the bank loaned to CORP the amount of $. The same asset was shown as owned by CO-21, and Foundation and donated by CORP. CO-22 did not pay any monies but rather acquired and forgave the loan and eventually received the property back.

The acquiring of the hotel from CO-22 by the supposed investors appeared to benefit the bank. The entities involved received multiple charitable contributions for the same property through ORG, CORP, and Housing Foundation. ORG perpetuated acts of creating "Mirror Entities" and used a professional appraisal service to document an overvalued basis in a property. As noted previously, the appraisal value was based on future improvement to the property that did not take place. During the entire period the property was not rehabilitated; there was no business activity, no business records for the spinoff partnerships, and no bank activity. This arrangement appeared to be a tax scheme that benefitted private and business investors.

Inaccurate documents were filed including indications of transfer or property via donation Form 8283 when no transfer had occurred. The filing appeared to reflect that a donation had been made; investors could then benefit from charitable contribution deductions and overstated losses. The same property was transferred between multiple entities for which the benefactors received improper tax benefits. Providing improper tax benefits is not an exempt purpose activity.

Inurement to Officer/Founder:

ORG distributed money to its founder and paid for his personal American Express charges. The principal and the interest on any purported loans have not been paid to ORG. Pursuant to ORG books, the amounts were recorded and indicated as a loan repayment to President. Both the Controller and Senior Vice President of Finance for ORG indicated that President received large sums of monies from ORG. No evidence (other than the amount recorded) was provided that any loan was made by the officer to ORG; further, it was a prohibited as a policy of the organization. No note to or from the officer was provided. The tax return reflected Loans from Officer in the amount of $ for the end of the year 20XX. The return for 20XX shows no amount owed.

The Service determined for the years ended December 31, 20XX through December 31, 20XX, with accumulated balances, that XXXXXXXXX received check payments from ORG, ORG CO-10 and ORG related organizations in the amounts of $, $, and $, respectively. These amounts represent cash XXXXXXXXX received from ORG. In addition, [redacted] received monies from the use of the corporate American Express card in the amounts of $ and $ for the years ended 20XX and 20XX, respectively.

Based on the factors discussed in Vinikoor v. Commissioner, T.C. Memo. 1998-152, the amount of money that ORG distributed to XXXXXXXXX does not meet the qualifications of a loan.

The Tax Court in Vinikoor explained that whether a transfer was made with a real expectation of repayment and an intention to enforce the debt depends on all the facts and circumstances including whether:
(1) There was a promissory note or other evidence of indebtedness;
(2) Interest was charged;
(3) There was security or collateral;
(4) There was a fixed maturity date;
(5) A demand for repayment was made;
(6) Any actual repayment was made;
(7) The transferee had the ability to repay;
(8) Any records maintained by the transferor and/or the transferee reflected the transaction as a loan; and
(9) The manner in which the transaction was reported for Federal tax purposes is consistent with a loan.

The transaction that was listed on the Form 990 as a loan does not meet the above criteria. No interest or investment income from the loan was ever reported on the Form 990. No interest on the principal was ever paid on the purported loan, as the interest was merely accrued into additional loans. Moreover, no executed loan document was provided.

The determination of whether there is a true debtor-creditor relationship is a factual question to be decided based on all of the facts and circumstances. According to the Tax Court, in Haag v. Commissioner, 88 T.C. 604, 615 (1987), aff'd without published opinion, 855 F.2d 855 (8th Cir. 1988) and Beaver v. Commissioner, 55 T.C. 85, 91 (1970), the recipient must intend to repay the amounts and the transferor must intend to enforce payment. Dean v. Commissioner, 57 T.C. 32, 43 (1971) provides that the determination of as to whether a loan exists is not based on a single factor, standing alone, but each factor is considered with all the facts and circumstances present.

The use of the assets of ORG for the personal use of President constitutes private inurement. To be described as an exempt organization pursuant to Internal Revenue Code section 501(c)(3), "no part of the net earnings inures to the benefit of any private shareholder or individual."

In Leon A. Beeghly Fund, 35 T.C. 490, 518 (1960), the Tax Court stated:

> We think that although the ultimate purpose of the trust to benefit charities may have remained unchanged by this transaction, nevertheless, the primary objective of the trust entering into this transaction was for the benefit of stockholders of [the business company] with the objective of ultimately benefiting charities running a poor second, and that when the trust was utilized for such a purpose it fell without the scope of both the language of section 101(6) [now Code §501(c)(3)] and the congressional intent in enacting this exemption provision.

Although the inurement prohibition is stated in terms of net earnings, it applies to any of a charity's assets that serve the interests of its private shareholders. Harding Hospital, Inc. v. United States, 505 F.2d 1068, 1072 (6th Cir. 1974). The payments to XXXXXXXXX served the financial interests of the XXXXXXXXX . When a charity's investments are decided in part by the needs of private interests, the charity is not operating exclusively for exempt purposes. Western Catholic Church v. Commissioner, 73 T.C. 196, 214 (1979), aff'd 631 F.2d 736 (7th Cir. 1980).

ORG's net earnings have inured to the benefit of insiders. Treas. Reg. § 1.501(a)-1(c); Ginsburg v. Commissioner, 46 T.C. 47 (1966). The very presence of a private source of loan credit may amount to inurement. Founding Church of Scientology v. United States, 412 F.2d 1197 (Ct. Cl. 1969); Church in Boston v. Commissioner, 71 T.C. 102 (1978). Loans to disqualified persons promote private rather than charitable purposes. Best Lock Corporation v. Commissioner, 31 T.C. 1217, 1235-37 (1959).

An organization is described in section 501(c) (3) only if no part of its net earnings inures to the benefit of any private shareholder. The inurement prohibition is designed to insure that charitable assets are dedicated to exclusively furthering public purposes. It is clear that part of the earnings of ORG inured to the benefit of its founder, and it is, therefore, not described by section 501(c)(3).

Conclusion:

ORG operated low-income housing properties and served some exempt purpose in so doing; nevertheless, ORG does not qualify for exempt status under section 501(c)(3) of the Internal Revenue Code for the following reasons.

(1) ORG also operated for non-exempt purposes to a more than insubstantial extent;

(2) ORG operated a scheme to mislead investors in order to maintain the operation of an insolvent organization and to benefit the founder and some initial investors;

(3) ORG promoted arrangements whereby investors received improper tax benefits;

(4) Further, the income of ORG inured to the benefit of the founder in the form of payments to him and payments for personal American Express charges.

Accordingly, it is determined that ORG is not properly described in section 501(c)(3) and its exempt status should be revoked effective January 1, 20XX.

Please note that this is not a final report. This draft report is subject to review and modification by our review staff. You will receive the final report from review.