



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Release Number: **200846040**

Release Date: 11/14/08

Date: August 21, 2008

UIL Code: 501.03-00

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

1120

Tax Years:

all

Dear :

This is our final determination that you do not qualify for exemption from federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code. On July 11, 2008, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. We did not receive a protest from you within the requisite 30 days, nor did you respond to a telephone message left with your officer, so the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in section 501(c)(3) of the Code, donors may not deduct contributions to you under section 170. You must file federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under section 6110 of the Code, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with section 6104(c) of the Code, we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Robert Choi
Director, Exempt Organizations
Rulings & Agreements

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: July 11, 2008

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

UIL: 501.03-00

Trustee A =
Trustee B =
POA 1 =
Year of Incorporation =
X =

IRS Letter #1 =
IRS Letter #2 =
IRS Letter #3 =
IRS Letter #4 =
IRS Letter #5 =
IRS Letter #6 =
IRS Letter #7 =
IRS Letter #8 =
IRS Letter #9 =
IRS Letter #10 =
IRS Letter #11 =

Response #1 =
Response #2 =
Response #3 =
Response #4 =
Response #5 =
Response #6 =
Response #7 =
Response #8 =
Response #9 =
Response #10 =
Response #11 =
Response #12 =

Dear :

We have considered your application for recognition of exemption from federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

FACTS

Your three Trustees own (or, in the case of one, had owned) a for-profit business. (See attached article.) Adjacent to the business is a house of worship that had been owned for many years by its congregation (apparently unrelated to the business or to you).

Formation

You were created on the date your certificate of incorporation was filed with the state. Three Trustees were named in the certificate of incorporation which also describes your purposes:

- a. To establish, maintain and conduct services for divine worship and religious observances in accordance with the customs and traditions of the [specified religion].
- b. To establish, maintain and conduct a facility for religious worship and prayer in accordance with the customs and traditions of the [specified religion].
- c. To purchase and lease such property both real and personal property and to mortgage such property as may be necessary for or incidental to the conduct and welfare of the corporation and the fulfillment of its religious purposes.
- d. To solicit contributions from the general membership in order to sustain said religious corporation.

Approximately 10 days after your incorporation, you contracted to purchase the property owned by the prior congregation. The purchase price was more than _____ dollars, with one quarter of the total due upon signing. The funds used to purchase the property were contributed by two sources: approximately half by the Family Foundation of one of your three Trustees, a private foundation recognized as exempt, and the rest by the business owned by your Trustees.

You represented that the contract was subject to the approval of the Attorney General and the Supreme Court of your state. In response to a petition, the Court, and the Attorney General, approved the sale in an order issued nearly two years later.

The sale closed six months after the Court approval. The closing statement reflects a purchase price in excess of _____ dollars with credit for a down payment equal to one quarter of the purchase price. At closing, you paid the remaining amount to the seller, and closing fees.

On the date that the sale closed, the Seller also executed a Bargain and Sale Deed with Covenant against Grantor's Acts (Deed). It conveyed the premises from the selling congregation to you. The Deed states that the conveyance was made "in consideration of [a

nominal sum of money] and other valuable consideration paid by the party of the second part," and pursuant to an Order of the Supreme Court of the state.

Application for tax-exempt status

We received your application for recognition of tax-exempt status approximately nine months after the sale closed. It bore the date of the closing, and was signed by Trustee A. You described your purpose as operating a house of worship following the specified religious tradition. You gave your address and the name of the person that you wished to be contacted for additional information.

Your application states that you have 20 active members and 15 people attending an average worship service. Your members meet to pray three times most days, and on a different schedule on the Sabbath and holidays. You represented that an appointed volunteer leads the congregants. You do not have any instruction for youth, and the only other religious activities that you conduct are religious studies. You do not require your members to renounce membership in other churches. Your services are publicized mainly by word of mouth. You attract new members through existing members and annual functions. You did not answer the questions about the number of hours per week your religious leader and officers devote to your work, or whether the religious leader is otherwise employed.

You stated that your established place of worship is in premises "owned by the congregation." However, you did not list the property in your Form 1023 balance sheet, where you said that your sole asset was a sum of money equal to one-eighth of the amount you paid for your house of worship.

You checked the box asserting that you were filing the application within 15 months from the month in which you were created. You stated on the front page of the application that you had been incorporated on the date of the real estate closing.

You represented that none of your Trustees is a disqualified person, none is related by family or business to a disqualified person and none will be compensated. You stated that your organization is not controlled by another organization and does not have a special relationship with another organization by reason of interlocking directorates or other factors.

The Statement of Revenues and Expenses filed with your application showed realized or expected revenues from gifts, grants and contributions of the same amount as you claimed in assets in each of the third, fourth and fifth years of your existence. You stated that you have no fundraising program. In response to the question asking for the name of anyone who had made substantial contributions of money or property and the amount, you said: "small private contributions."

Your budgetary information listed only two expenses for each of the years covered in your application. In each year you said that you would disburse the same amount of money as you expected as revenue in contributions, gifts, grants, and similar amounts. You did not include a required schedule to show more detail. In each year you also expected to have less than \$1000 in other expenses, but did not include a required schedule.

You enclosed a copy of your Certificate of Incorporation but did not include by-laws.

Subsequent correspondence and events

Approximately three months after you filed your application, the IRS sent Letter #1 to you, at the address you had given on your application, requesting additional information needed to consider whether you qualified for exemption. The letter requested a copy of your by-laws, or a statement signed by a principal officer that you did not have by-laws. It also asked for more explanation of how you owned your facility, and for a deed or other documentation. The letter was returned undeliverable. Ultimately, the agent was able to contact the person whose name you had given as the contact person on the application.

More than three months after the IRS Letter #1, you sent a power of attorney form (POA) designating the contact person as your representative.

Trustee A died approximately two months later. (See attached notices of death.)

You made Response #1 to the Service in a letter during the following month. It enclosed a copy of the Bargain Sale and Deed, described above. It was signed by a person not covered by a power of attorney. The letter did not contain by-laws.

The IRS sent Letter #2 one month later. This letter requested either a copy of your by-laws or an explanation of how you operate and your form of governance. It also asked for more details about the contributions that you listed as an expense, and for interior and exterior photographs of your facility, and whether you were related to or affiliated with any other organization.

Your second response sent approximately five weeks later, was signed above a typed legend reading: "Trustee A, Trustee."

In response to the question about by-laws, you stated that "the Congregation does not have by-laws." You did not explain how the trustees make decisions, or what relationship they have with the congregation. You affirmed that you are unaffiliated with other organizations. In response to questions about your grant-making, you stated that you would donate to "Any tax exempt entity" and to "Any indigent individual with extraordinary hardship." You explained your selection decisions as: "Committee evaluates need after Trustee interviews potential recipient" and that the "Congregation relies on the Trustees' decision" to assure that qualifications are actually met. The Board of Trustees determines whether funds actually further exempt purposes.

You enclosed interior and exterior photographs. The exterior photos appear to be of two different buildings. The interior pictures appear to depict two different rooms, one of them a more formal religious sanctuary, and one an all-purpose room containing some religious objects.

A few weeks later, there was a deposit of \$ made to your bank account. The next day, you faxed to us an undated contract to sell your property to an unrelated entity that indicates a

sales price of nearly double the amount you paid, with about 7 percent provided on signing, to be held in an escrow account.

Letter #3 from IRS (a week later) asked just two questions: why the mail addressed to your address was being returned as undeliverable, and how you operate and make decisions.

Your bank statement shows a withdrawal by check of \$ _____, approximately one month later.

One month after the IRS Letter #3, you provided a one-page Response #3. Over a typed legend reading "Trustee A, Trustee", there were six brief numbered responses, none of which related to the questions asked in the prior letter from IRS. This letter referred to, but did not attach, "initialed and dated Form 1023 pages 6 & 10". It also referred to "bank records and statements" without further explanation.

Letter #4 from the IRS (one month later) asked for a copy of the questions to which your third response was replying because it did not appear to be responding to Letter #3 from the IRS. This letter also requested the pages 6 & 10 referred to, or an explanation, and the bank records and statements referred to or an explanation. This letter reiterated the two questions from Letter #3.

In response to the third and fourth letters, on the same date as Letter #4 from the IRS, POA 1 faxed a one-page Response # 4 containing two numbered items, reading in their entirety:

1. Mail delivered to [your address] is the wrong address. The correct address for the Congregation is [the address of the adjacent business att: Trustee B, Trustee].
2. The Congregation is governed by a Board of Trustees who have the full power to make all decisions pertaining to the congregation.

It is signed above a typed legend reading: "Trustee A, Trustee."

A few days later, POA 1 was suspended from practice before the IRS, for reasons unrelated to this application.

About a week after your fax, IRS sent Letter #5. This stated that the fax received had not answered the first three questions in IRS Letter #4 and asked for responses or an explanation why they could not be answered

Three days later POA 1 faxed your Response #5 that stated:

Our response crossed in the mail with your letter annexed hereto

Form 1023 pages 6 & 10 were attached
Bank records and statements were attached
Hopefully this will resolve the matter

Nothing was attached.

The following day, you sent Response # 6, a one-sentence cover page stated:

With reference to my fax to you on the date of Response #5 the annexed letter was omitted erroneously.

Underneath was a typed legend reading, "Trustee A Trustee."

A second page also signed and labeled, "Trustee A, Trustee" reads:

Attached hereto is the information you requested on your [IRS Letter #4] correspondence to the above referenced entity.

Enclosures:

Form 1023 pages 6&10 initialed and revised.

Bank statements from Bank for you.

Response to the undeliverable mail to the congregation.

Response to the form of governance for decisions and operational techniques.

Attached were poorly reproduced copies of pages 6 and 10 of a Form 1023 application. These pages differ in several respects from the Form 1023 that you filed initially. Most importantly, this balance sheet showed less than one-tenth the amount of cash on the balance sheet included with your application.

Bank Statements from your Bank for the preceding ten months were included. Each one had the following address at the top:

Your name

A different address

Each one was labeled:

Statement Summary

Checking Account

BUSINESS Description Your name ACCT #

During the ten month period, two deposits were recorded; one, for \$, and one, three months later for \$. Many checks were written over the ten months, but only two were for amounts greater than \$1000. The first was a check for nearly \$ and the second, dated a month after the largest deposit, was for \$.

About three weeks later, the IRS sent Letter #6 that contained questions regarding the pages of Form 1023 and bank statement that you previously submitted.

Two months later, the IRS received your Response #7, signed above a typed legend reading, "Trustee A, Trustee."

Five checks were explained as payments to "professional [liturgy] readers" who were members of your congregation, and you stated that the amount is standard for such services.

One item explained that a check for \$ paid for building insurance, the only expense recorded during the application process for your building, other than its purchase.

Another item referenced the check for \$, and explained in its entirety: "This was a loan for religious services to X, a tax exempt organization."

The last item read in its entirety:

"Business Description Accounts are linked together with an account of an entity with which one of the officers is associated, so that there are no bank fees on the charity's account, even if it does not maintain minimum balance.

About ten days later, the IRS sent Letter #7. This letter was primarily concerned with the loan, and the check described as a deposit for purchase of a building. It also asked about the discrepancy between the balance shown on the "page 10" included with your last two letters, and the balance of ten times that much indicated on your original application, and for a current balance sheet and property asset information. IRS also asked for actual financial data (not rounded, estimated or budgeted amounts).

Three weeks later, you replied over the signature of Trustee B, Trustee (Response #8). You stated that the recipient of the loan is a congregation located at a particular address and exempt under IRC 501(c)(3). The \$ was a "bridge loan made to this organization that was to be repaid from monies raised at their anniversary celebration. The money was repaid by check dated [approximately four months after the loan was made]." You did not describe the terms or conditions of the loan, or how it relates to your purpose and activities.

You explained the discrepancy between the cash balance in the initial balance sheet and the cash balance in the balance sheet submitted more recently in the following terms:

Part IX information initially did not reflect a building purchased by [you] for [the purchase price] with contributions specifically earmarked for such purchase during [three years].

Until this point, you had only provided the Deed which indicated that the property was transferred for \$ and other valuable consideration.

You submitted a new Statement of Revenues and Expenses for the year after you were incorporated and the succeeding three years. This showed revenue of the amount for which you purchased your building consisting of gifts, grants, and contributions for the first three years. The only revenue for the fourth year was the amount of the large deposit in "net gain on sale of capital assets." For the fourth year, you also listed an expense of something in excess of the

amount of the loan to the other exempt organization as "contributions, gifts, grants," but did not attach the required itemized list. The only other expenses were under \$1000 in professional fees for each of the three most recent years. You did not include any expenses pertaining to the occupancy or maintenance of your building.

The Balance sheet for the fourth year after you were incorporated stated that you have an amount of cash somewhat greater than the amount you described as a deposit for the purchase of a building, and a building at your address, valued at the amount shown on the purchase contract. A liability of an amount somewhat in excess of the amount that you described as a loan to another exempt organization is listed as a grant payable. A note below the balance sheet states that: Building value has appreciated since the period shown above.

You said that the building:

Is being sold by the congregation after it decided not to relocate to the new building but instead continue to conduct their activities at their current location.

Up to this point, you had described your activities as being conducted in the building at your address. Your response did not explain what your current location was.

Letter #8 from the IRS was dated about four months after your Response #8. You and your attorney were advised of fifteen material items of information that you had not provided and discrepancies that you had not explained. Included among them are:

- Financial data (actual)...that was requested has not been provided.
- ...grant and assistance program has not been adequately explained.
- ...connection to business has not been adequately explained
- The organization has not adequately described their governance and how decisions will be made.
- Balance sheet discrepancies have not been explained.
- Financial records do not match the reported financial data ...in the application.
- The building purchase and related expenses have not been completely described.

You provided a written response by fax one month later, (Response #9) signed by "Trustee B, President. Attached to the letter was an invalid Form 2848 appointing two new representatives, POAs 2 and 3. You submitted a valid Form 2848 for the two new representatives two weeks later. You included a revised statement of revenues and expenses that had "been prepared by the accountants based on actual statements." You did not explain how it differed from prior statements or why.

In response to the IRS request to explain the discrepancies among the many addresses in the file you stated that they were simply changes that had occurred over time. You mentioned that: "a major board member, who initially had mail sent to his address unfortunately died. His address was [the one that had been on the bank statement]" but you did not say who he was or when he had died. In response to our question why mail could not be delivered to your premises, you stated: "Another address is" You continued the list: "Another address is ...

which is a building next door which allows this [congregation] to use its facilities for continued operation of the [church], which is handicap and wheel chair accessible." This is the first written mention of using the business facility for your activities.

You stated that the "[congregation] is made up of elderly individuals who cannot afford to have a grant or assistance program. However to the extent that they do give to other organizations, they will adhere to their By-Law that are annexed hereto." The by-laws are not signed or dated, do not contain evidence they have been adopted, and contain some clauses that appear to refer to a different kind of organization. They also list a Trustee who had not previously been disclosed.

You asserted that your connection to "[business]" has been explained numerous times. You also stated "the membership of older people who pray daily at the [religious facility]...realized that they could not afford the maintenance of a [religious] building." You were "fortunate to have been provided by a neighboring [business] the use of a recreation room at the [business] for the daily religious services of the [congregation]."

You explained that you do not pay salaries because you hire independent contractors for approximately \$65 a week for liturgy reading and professional religious leaders for special holiday services.

You reiterated your explanation of the loan to the other exempt organization, adding that it was "non-interest bearing." You attached a photocopy of a check made payable to you "as best proof that the terms and conditions of the bridge loan were fully satisfied." The copy was only of the front of the check.

You added to your explanation of your reasons to sell the building. In addition to not being accessible to persons in wheelchairs, you said that you found that it had "building violations, needed significant repairs and was very expensive to maintain."

The revised Statement of Revenues and Expenses differs greatly from the one you submitted with your application (covering the same years with the addition of your second year). You did not submit any explanation, schedules, lists, or documentation to explain the differences or support this version.

You submitted a Balance Sheet for your fourth year that shows land and a building worth more than the amount on the purchase contract. It also shows as an asset, a "loan receivable" of the amount that you had previously described as a loan. The Balance Sheet also shows a deposit on a contract to sell, characterized as a liability.

Letter #9 from the IRS was dated a month later. This letter contained questions about items provided in your last communication and in a phone conference. In particular, the Agent asked whether the funds used to purchase your building were donations from public charities, and whether they were loans. He inquired about any taxes owed on the property, about your by-laws and the purchase and pending sale of your property.

Your Response #10, dated two weeks later, was signed by Trustee B. It included a revised balance sheet that indicated it covered your fifth year, and includes a religious object valued at more than \$ as an asset.

The origin of the funds used to purchase your building is described as follows:

Half of the... cost of the [religious organization] building came from monies that were contributed by the Trustee A Family Foundation, an IRS approved 501(c)(3) organization. The remaining half of the cost was from new monies that came as donations made directly to the [religious organization] as a direct donation to the [religious organization] after it was incorporated under the ... State Religious Corporation Law. None of the monies contributed toward the purchase of the building were loans.

You explained that no taxes are owed because your state exempts churches from real estate transfer and property taxes.

You explained that you had adopted by-laws "in early [your fifth year] in response to [the first] letter from...the IRS implying that it was appropriate." You said that the now deceased president had kept them and they were not located until recently.

You confirmed the amount which you paid for your facility on the date of the closing statement and deed, and attached the contract of sale and closing statement.

With respect to your sale of the property, you submitted a contract that is not dated, and does not contain a block and lot number or legal description of the property. On the copy we received, your attorney had not signed the line indicating that he had received a check to deposit in escrow. In your written response, you clarify that the sales price was the amount on the contract, nearly double what you had paid.

You explained that your attorneys have not yet submitted a request for approval of the sale to the Attorney General and the Supreme Court because they have to have the IRS approval letter first. You express the hope that the IRS will expedite its decision to help preserve the "opportunity for the charity to close on a sale of its building that is deteriorating and losing value."

Letter #10 from the IRS was dated a week later. This letter asked for a more complete explanation of the sources of the funds for purchase.

You replied a week later, in Response #11. You described the origin of the funds used to purchase your facility:

half came from the Trustee A Family Foundation in the amount of.... This Foundation is a 501(c)(3) organization that is an IRS approved private foundation. The other amounts, [slightly more than one-quarter] and [slightly more than one-quarter] were donated by [adjacent business] that was anxious to have a nearby congregation available for its elderly residents.

Letter #11 from the IRS was dated one week later. This letter asked whether you had ever used the property at your address, whether anyone else had, and why you bought a building you could not use. It also asked for some additional information about the adjacent business.

You replied approximately one week later in your final Response, # 12, over the signature of Trustee B. You described the use of your facility. From the time it obtained a certificate of occupancy as a church, fifty years ago, the prior organization had used the property as a church. Its board was planning to close the church building:

that was used by community members as well as residents of the neighboring [business] and sell the [church] building to a [foreign] agency. Community members, including the neighboring [business], whose residents and staff attended prayer services at the neighboring...[our organization] decided to raise money to purchase the [church] from the existing [religious organization] so that they would have a continuing [religious organization] for the community and [business] residents...that would be further improved by anticipated wheel chair accessibility.

You said that you also used the facility as a church, but you explained that:

When the building was purchased it was expected that a ramp could be built a few steps down so that it could become wheel chair accessible and that an elevator could be built to then go up to street level. This would accommodate the needs of the residents of the business who needed wheel chair accessibility. While these plans were being considered, prayer services were being held at [your address] as well as at a designated portion of the [business] facility. At some point after the purchase of the building was consummated, it was determined that the necessary repairs as well as the upkeep of the [your address] facility were very expensive and the temporary arrangement to have [church] services held at the designated area of the [business] was a more advisable less expensive permanent alternative and the decision to sell the [your address] building was then made.

You described the adjacent business as a "proprietary for-profit entity," and that its current governing body members are: Trustee B, a person with the same last name as Trustee B and a person with the same last name as Trustee A.

You stated that two of the pictures that you had submitted are of your religious facility, and the

remaining three pictures are pictures of the designated [religious] area at the [business] that was initially the temporary and now is the permanent location of continuing ...prayer services for both residents of the [business] and outside community members.

LAW

Section 501(c)(3) of the Code exempts from federal income tax corporations organized and operated exclusively for religious and charitable purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual.

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

Section 1.501(c)(3)-1(b)(1)(i) of the regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization:

- (a) Limit the purposes of such organization to one or more exempt purposes; and
- (b) Do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities that in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that 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.

Section 1.501(c)(3)-1(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. Section 1.501(a)-1(c) defines the words "private shareholder or individual" in section 501 to refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(i) of the regulations states that an organization may be exempt as one described in section 501(c)(3) of the Code if it is organized and operated exclusively for one or more purposes, such as religious or charitable purposes, designated in that section.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations assigns the burden of proof to an applicant organization to show that it serves a public rather than a private interest and specifically 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.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and is not limited by the separate enumeration in section 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of "charity" as developed by judicial decisions.

Rev. Rul. 77-366, 1977-2 C.B. 192, states that a religious tour which had extensive social and recreational activities is not operated exclusively for exempt purposes and thus does not qualify for exemption.

Rev. Rul. 56-262, 1956-1 C.B. 131 provides that in order to be recognized as a church under the Code, an organization must have as its principal purpose or function that of a church.

Rev. Proc. 2008-9, 2008-2 I.R.B. 1, superseding Rev. Proc. 90-27, 1990-1 C.B. 514, in Section 4.01, provides that the Internal Revenue Service will recognize the tax-exempt status of an organization only if its application and supporting documents establish that it meets the particular requirements of the section under which exemption from federal income tax is claimed. Section 4.03 provides that exempt status may be recognized in advance of the organization's operations if its proposed operations are described in sufficient detail to permit a conclusion that it will clearly meet the particular requirements for exemption pursuant to the section of the Code under which exemption is claimed. Section 4.03(2) states that the organization must fully describe all of the activities in which it expects to engage, including the standards, criteria, procedures or other means adopted or planned for carrying out the activities, the anticipated sources of receipts, and the nature of contemplated expenditures.

In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. The Court found that the trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university.

In American Institute for Economic Research v. United States, 302 F. 2d 934 (Ct. Cl. 1962), the Court considered an organization that provided analyses of securities and industries and of the economic climate in general. It sold subscriptions to various periodicals and services providing advice for purchases of individual securities. The court noted that education is a broad concept, and assumed *arguendo* that the organization had an educational purpose. However, the totality of the organization's activities, which included the sale of many publications as well as the sale of advice for a fee to individuals, was indicative of a business. Therefore, the court held that the organization had a significant non-exempt commercial purpose that was not incidental to the educational purpose, and was not entitled to be regarded as exempt.

In Stevens Bros. Foundation, Inc. v. Commissioner, 324 F.2d 633 (10th Cir. 1963), affirming 39 T.C. 93 (1962), an organization's exemption was revoked for failure to operate exclusively for charitable purposes where it entered into a partnership with and advanced funds to a for-profit entity owned and controlled by the organization's directors. The for-profit entity needed the funds to obtain construction contracts, which ultimately proved profitable. The court reasoned that the organization engaged in the transactions substantially for the purpose of benefiting its founders.

Bubbling Well Church of Universal Love, Inc. v. Commissioner of Internal Revenue, 74 T.C. 531 (1980). In an action for declaratory judgment pursuant to section 7428(a), the Court considered an adverse ruling by the IRS on an application for exempt status as a church. The Court noted that the only voting members and directors of the organization were a husband and wife and their son, who had no affiliation with any denomination or ecclesiastical body or other outside influence. The applicant had declined to furnish some information, and made answers to other inquiries that were vague and uninformative. On the basis of the record, the Court held that the

applicant had not shown that no part of its net earnings inure to the benefit of the family or that petitioner was not operated for the private benefit of the family.

Western Catholic Church v. Commissioner of Internal Revenue, 73 T.C. 196 (1980). The petitioner's only activities were some individual counseling and distribution of a few grants to needy individuals, while its primary activity was investment of funds. The directors borrowed money in its name, but used some of it for automobiles and to pay off personal loans. The petitioner's failure to keep adequate records and its manner of operation made it impossible to trace the money completely, but the court found it clear that money passed back and forth between petitioner and its director and his for-profit businesses. The Court held that petitioner had not shown it was operated exclusively for exempt purposes or that no part of its earnings inured to the benefit of its officer.

In Basic Bible Church v. Commissioner, 74 T.C. 846 (1980), the court found that although the organization did serve religious and charitable purposes, it existed to serve the private benefit of its founders, and thus failed the operational test of section 501(c)(3). Control over financial affairs by the founder created an opportunity for abuse and thus the need to be open and candid, which the applicant failed to do.

In American Guidance Foundation, Inc. v. United States, 490 F.Supp. 304 (D.D.C. 1980), the court recognized the 14-point test developed by the Internal Revenue Service for determining whether a religious organization was a "church" within the common meaning an usage of the word. Developing the administrative criteria was necessary because the Internal Revenue Code does not provide a definition of the term church. The 14 criteria, which were identified from historically or judicially recognized objective characteristics of churches, are:

- 1) a distinct legal existence;
- 2) a recognized creed and form of worship;
- 3) a definite and distinct ecclesiastical government;
- 4) a formal code of doctrine and discipline;
- 5) a distinct religious history;
- 6) a membership not associated with any other church or denomination;
- 7) an organization of ordained ministers;
- 8) ordained ministers selected after completing prescribed studies;
- 9) a literature of its own;
- 10) established places of worship;
- 11) regular congregations;
- 12) regular religious services;
- 13) Sunday schools for religious instruction of the young; and
- 14) schools for the preparation of its ministers.

Referring to these 14 points, the court stated, at 306:

While some of these are relatively minor, others, e.g. the existence of an established congregation served by an ordained ministry, the provision of regular religious services and religious education for the young, and the dissemination of a doctrinal code, are of central importance.

In Basic Unit Ministry of Alma Karl Schurig v. Commissioner, 670 F.2d 1210 (1982), the Court affirmed the denial by the court below of a declaratory judgment that the applicant was entitled to exempt status as a religious organization. In factual situations where there is evident potential for abuse of the exemption provision, a petitioner must openly disclose all facts bearing on the operation and finances of its organization. Here Plaintiff did not proffer sufficiently detailed evidence of its charitable disbursements, or the extent of its support of its members. Plaintiff has continually responded that it had already provided the data, or could not furnish anything further. Therefore, the court found that the applicant did not meet its burden to positively demonstrate that it qualifies for the exemption.

In National Association of American Churches v. Commissioner, 82 T.C. 18 (1984), the court denied a petition for declaratory judgment that the organization qualified for exempt status as a church. In addition to evidence of a pattern of tax-avoidance, the court noted a failure to respond completely and candidly at the administrative level. An organization may not declare what information or questions are relevant in a determination process. It cited a number of declaratory relief actions that upheld adverse rulings by the Service because of the failure of the applicants to provide full and complete information on which the Service could make an informed decision.

In P.L.L. Scholarship v. Commissioner, 82 T.C. 196 (1984), an organization operated bingo at a bar for the avowed purpose of raising money for scholarships. The board included the bar owners, the bar's accountant, also a director of the bar, as well as two players. The board was self-perpetuating. The court reasoned that, because the bar owners controlled the organization and appointed the organization's directors, the activities of the organization could be used to the advantage of the bar owners. The organization claimed that it was independent because there was separate accounting and no payments were going to the bar. The court was not persuaded.

A realistic look at the operations of these two entities, however, shows that the activities of the taxpayer and the Pastime Lounge were so interrelated as to be functionally inseparable. Separate accountings of receipts and disbursements do not change that fact.

The court went on to conclude that, because the record did not show that the organization was operated for exempt purposes, but rather indicates that it benefited private interests, exemption was properly denied.

In Easter House v. United States, 846 F. 2d 78 (Fed. Cir. 1988), aff'g 12 Cl.Ct. 476 (1987), the court found an organization that operated an adoption agency was not exempt under section 501(c)(3) of the Code because a substantial purpose of the adoption activity was a non-exempt commercial purpose. The Court reviewed the law holding that an organization need not operate "solely" for exempt purposes, but that no more than an insubstantial part of an organization's activities may further a non-exempt purpose. In this case, the adoption services did not further the exempt purposes of providing educational and charitable services to the unwed mothers and children. Rather, the services for unwed mothers and children were merely provided "incident" to the organization's adoption service business, which was substantial.

In addition to furthering a substantial non-exempt purpose, the court found that a portion of the organization's net earnings inured to the benefit of a private shareholder or individual as defined by sections 1.501(c)(3)-1(c)(2) and 1.501(a)-1(c) of the regulations. The organization provided a source of credit (i.e. loans) to companies in which the private shareholder was either employed by or owned. The fact that the loans were made showed that the companies controlled by the private shareholder had a "source of loan credit" in the organization.

New Dynamics Foundation v. United States, 70 Fed.Cl. 782 (2006), was an action for declaratory judgment that the petitioner brought to challenge the denial of his application for exempt status. The Court found that the actual purposes displayed in the administrative record supported the Service's denial. If the petitioner had evidence that contradicted these findings, it should have submitted it as part of the administrative process. "It is well-accepted that, in initial qualification cases such as this, gaps in the administrative record are resolved against the applicant," at 802.

RATIONALE

Exemption from federal income taxation is not a right, it is a matter of legislative grace that is strictly construed. New Dynamics, *supra*. The burden is on the applicant to prove that it is entitled to exempt status. *Id.* An applicant must prove that it is organized and operated exclusively for exempt purposes and not for the private benefit of its creators, designated individuals or organizations controlled by such private interests. Treas. Reg. §1.501(c)(3)-1(d)(1)(ii). Exclusively does not mean "solely," but no more than an insubstantial part of an organization's activities may further a non-exempt purpose. Better Business Bureau, Easter House, *supra*.

An applicant for exempt status must provide sufficient information for the IRS to make an informed decision. National Ass. of American Churches, *supra*. It must respond to questions completely and candidly. *Id.* The responses must include details, figures, and documentation. Basic Bible Church, *supra*. The IRS has statutory and regulatory authority to inquire about an applicant's proposed activities and other subjects material to its determination of whether the applicant meets the standards for exempt status. Rev. Proc. 2008-9. Particularly where a small, related board provides potential for abuse of exemption provisions, the applicant must openly and candidly disclose all facts bearing on the finances and operation of its organization. Basic United Ministry of Alma Karl Schuring, *supra*.

Each application must be signed by an authorized official, under a statement that:

I declare under the penalties of perjury that I am authorized to sign this application on behalf of the above organization and that I have examined this application, including the accompanying schedules and attachments, and to the best of my knowledge it is true, correct, and complete.

Evidence submitted by the applicant must be substantial and conclusive. Rev. Proc. 2008-9. Documentation must be more than superficially responsive.

It is not enough that a corporation believes and declares itself to be a church. Nor is it sufficient that the applicant prepares superficially responsive documentation for each of the established IRS criteria. To hold otherwise would encourage sham representations to the IRS and result in adverse tax consequences to the public at large. American Guidance Foundation, *supra*.

Vague and inconclusive materials and gaps in the record will be resolved against the applicant. New Dynamics, *supra*, citing “numerous other §7428 cases in this court and elsewhere to similar effect.”

Where, as here, an organization is completely controlled by its creators, without participation by members, the community or even the oversight of a religious denomination, the opportunity for abuse makes vital an open and candid disclosure of all the facts about the organization and its operations, so that the Court can be assured that it is not sanctioning an abuse of the revenue laws. Bubbling Well Church, *supra*.

Failure to Establish Right to Exempt Status

You must establish that you are entitled to exemption from federal income tax, and, with a small governing body controlled by your founders, have a special need to be open and candid. In light of the changes, contradictions, and missing information in the material that you have submitted, we cannot conclude that you have established that you have operated and will operate exclusively for exempt purposes, nor have you established that your operations will not serve your founders' private purposes. We discuss below some of the most material of the factual deficiencies in your administrative record.

- You did not notify the Service when one of your three Trustees died in the Spring of your fifth year, and you repeatedly submitted documents purported to be signed by the deceased Trustee after that date.
- You were not forthcoming about the value of your most valuable asset. Although you had completed purchase of the building at your address nine months before submitting your application, you did not provide a value for that asset in the application. In response to specific questions about the property, you merely submitted the Deed that recited transfer of the property for a nominal sum and other valuable consideration. Finally, in your Response #8, you revealed that you had purchased the building for a specific amount with “contributions.” A revised balance sheet assigned that value to the building, and although you included a note that it had appreciated, you did not state by how much. However, by the time you provided the revised balance sheet you had already signed a contract to sell the property for almost twice that amount. Nearly two years after you first applied for exempt status, you disclosed this sales price.
- You were not forthcoming about your relation to a for-profit business connected to your

Trustees. Your application states that you do not have a special relationship with any other organization, and that none of your Trustees is a disqualified person. In Response #10, you reiterated that you were not affiliated with any other organization. However, you eventually stated (Response # 7) that your bank account is "linked" with the bank account of a business "with which one of the officers is associated." The address on that bank account is the same as the home address given in the application for Trustee A. Later, you also stated (Response #11) that over half of the funds used to purchase the property at your address was given to you by the adjacent business. Still later, (in your Response #12) you stated that you had been holding religious services in the business from your inception, and that its three governing body members include Trustee B. Attached newspaper articles show that three of your Trustees were partners in the adjacent business.

- You obscured the amount and sources of your revenue. Your application stated that you would receive "small private contributions." You paid the smaller user fee assessed for organizations expecting less than \$10,000 in revenue per year. However, you did not submit evidence that you received such small contributions, and the bank records do not reflect any. In Response #8, you revealed that the amount to purchase the property had been contributed, but you did not say by whom. In Response #10, you said that half came from the Trustee A Family Foundation, and described the rest as "donations" made directly to the [religious organization]. Later, in Response #11, you explained that the unnamed contributor was the adjacent business.
- By-laws. In response to the second direct question about your by-laws, you stated in Response #10 that you do not have by-laws. You did not answer several requests to describe the way that you govern and make decisions in the absence of by-laws. However, you attached to Response #9 a copy of by-laws that you later said (Response #10) had been adopted early in your fifth year of existence. Thus, you said that you had adopted them months before you represented that you did not have by-laws. The by-laws submitted with Response #9 were not signed or dated, and were not accompanied by evidence that they had been adopted by your Trustees. They refer to a Trustee who had not been designated as such in your application or certificate of incorporation.
- You submitted photographs that did not depict what you originally claimed. Enclosed with Response #10 were photographs which you described as "pictures of the inside and outside of the worship facility." They appear to be pictures of more than one facility. In your final Response, #12, you stated that two pictures are of the worship facility at your address, and the remaining three pictures are of the designated worship area at the business. There were actually eight pictures.
- You represented that you were exclusively using the facility at your address for religious purposes. You gave only that address (although mail could not be delivered there) in the application and in correspondence over several months. You provided pictures (of the interior and exterior of the business) that you implied showed the facility at your address. You made no reference to conducting services at the business until Response #9.

- You have not adequately explained the circumstances of the \$ loan and its relationship to your exempt purpose, nor of the source of the check for \$ that appears in your bank statement. (You referred to this as a down payment on the building, but the contract of sale specified a larger deposit into an escrow account rather than your bank account.)

You have failed to explain the above discrepancies.

Not Organized or Operated Exclusively for Exempt Purposes

You have not established that you are organized or operated exclusively for exempt purposes. Your structure of control by a small number of people who are partners in another business creates the potential for abuse of exemption provisions as discussed in Basic Unit Ministry, National Ass. of American Churches and Bubbling Well supra. The record of your submissions and responses does not provide complete information in sufficient detail to demonstrate that you operate exclusively for exempt purposes. In fact, the record includes evidence that you are organized and operated in a manner that allows for non-exempt purposes and private benefit to those who created you, in violation of Treasury Reg. 1.501(c)(3)-1(d)(ii). At best, in light of the vast inconsistencies in your representations and submissions, we must conclude that you have not established that you operate for exempt purposes or that your operations will not serve the private interests of your founders.

Your certificate of incorporation and your by-laws give total authority to your three Trustees. The congregation has no role or power over your affairs. There is no provision for election of Trustees by the congregation. The congregation cannot review your decisions after they are made because your Trustees do not keep written minutes of their meetings. Your bank account is "linked" to that of a for-profit entity affiliated with your Trustees. The bank statements are mailed to the home of one of your Trustees. The Trustees own the facility where the worship takes place, write the budget, approve expenditures, hire and pay liturgy readers and religious leaders. Because you are not part of an organized church, you are not accountable to any other body. You summed up your organizational structure by saying: "The Congregation is governed by a Board of Trustees who have full power to make all decisions pertaining to the congregation." (Response # 4).

You have not demonstrated that your Trustees use their control for exempt rather than private purposes. There is evidence that your real estate dealings will benefit the Trustees: they own a business adjacent to your property, your bank account is "linked" to the business, and the business and the private foundation of one of the Trustees provided the funds to purchase your building.

Evidence of Significant Non-Exempt Purpose

The record strongly suggests that the primary focus of your operations was consummating a real estate transaction. Therefore, you have not established that you engage primarily in activities that further exempt purposes. For example, the purchase and sale of the building at your address, which does not further your particular religious purpose, has appeared to

dominate your purposes and activities, and effectively dwarfs any religious activities you claim to provide to your congregation. You have not overcome the evidence that significant non-exempt purposes, rather than charitable and religious purposes, guided the actions of your Trustees.

Failure to Establish that You are Operated Exclusively as a Church

Even if you operated exclusively for exempt purposes, you have not established that you meet the requirements for classification as a church under section 170(b)(1)(A)(i). There is very little evidence in the administrative record showing church activities that meet the fourteen points discussed in American Guidance Foundation, *supra*. You do not have any clergy of your own. You hire independent contractors to read weekly, and religious leaders for important holidays. You did not offer any evidence that the readers or religious leaders that you hire have been ordained after a course of study. You stated that you do not perform any other religious rituals: no weddings or funerals, for example. Your members need not renounce other affiliations. You have no ecclesiastical government, nor school for youth. You have not offered any evidence to show that you are open to the public, or endeavoring to increase your membership.

Nor is there any evidence in the record of activities often undertaken by churches such as counseling members or providing aid to the needy. (In spite of your initial assertion of a large grant program in your application, you later said that you would probably not be giving grants.) There is no other evidence in the record that you did in fact give aid to needy individuals or organizations.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to protest as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

Internal Revenue Service
TE/GE (SE:T:EO:RA:T:)

1111 Constitution Ave, N.W.
Washington, DC 20224

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

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

Sincerely,
Robert Choi
Director, Exempt Organizations
Rulings & Agreements

Attachments:

Two death notices
Newspaper article
IRB Notice on POA suspension