



DEPARTMENT OF THE TREASURY

Internal Revenue Service
TE/GE EO Examinations
1100 Commerce Street M/C 4920 DAL
Dallas, TX 75242

**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

Date: **MAR 19 2018**

Number: **201829013**
Release Date: 7/20/2018

Person to Contact:
Identification Number:
Telephone Number:
In Reply Refer to:

UIL: 501.03-00

LAST DATE FOR FILING A PETITION
WITH THE TAX COURT:

CERTIFIED MAIL - Return Receipt Requested

Dear :

This is a Final Adverse Determination Letter that your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC) is revoked. Recognition of your exemption under IRC section 501(c)(3) is revoked effective July 1, 20

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

You have not demonstrated that you operated exclusively for an exempt purpose as described in section 501(c)(3).

Treasury Regulation section 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not operated exclusively for exempt purposes unless it serves a public rather than a private interest. We hereby determined that you operated for the benefit of private interests of a private individual by regularly providing substantial sums to a trustee without appropriate justification.

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

You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the year ending June 30, 20 and for all years thereafter.

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

As you were a private foundation as of the effective date of the revocation, you are a taxable private foundation until you terminate your private foundation status under section 507 of the Internal Revenue 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.

If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claim Court or the District Court of the United States for the District of Columbia before the 91st day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment.

The Taxpayer Advocate Service (TAS) is an independent organization within the IRS that can help protect your taxpayer rights. We can offer you help if your tax problem is causing a hardship, or you've tried but haven't been able to resolve your problem with the IRS. If you qualify for our assistance, which is always free, we will do everything possible to help you. Visit taxpayeradvocate.irs.gov or call 1-877-777-4778.

We will notify the appropriate State Officials of this action, as required by section 6104(c) of the Internal Revenue Code.

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

Sincerely yours,

A handwritten signature in black ink that reads "Maria Hooke". The signature is written in a cursive, flowing style.

Maria Hooke
Director, Exempt Organizations Examinations

Enclosure:
Publication 892



Department of the Treasury
Internal Revenue Service
Tax Exempt and Government Entities
Exempt Organizations Examinations

Date:
September 7, 2017
Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact / ID Number:

Employee ID:
Contact Telephone Number:

Contact Fax Number:

Manager's Name / ID Number:

Employee ID:
Manager's Contact Number:

Response Due Date:

Certified Mail – Return Receipt Requested

Dear :

We've proposed adjustments to the amount of tax you owe for the tax year or years listed above. The enclosed report of examination explains the proposed adjustments as well as any required correction.

If you agree, you should:

1. Sign and date the enclosed Form 870-E, *Waiver of Restrictions on Assessment and Collection of Deficiency and Acceptance of Overassessment*, and return it to the contact person at the address listed above within 30 calendar days from the date of this letter.
2. Provide proof that you've made any required corrections.
3. Enclose payment of the tax, interest, and penalties. If you owe additional tax, it's to your advantage to pay the full amount. Please make your check or money order payable to the **United States Treasury**. The enclosed Publication 3498, *The Examination Process*, provides additional payment information.

If you can't pay the full amount, please call the contact person at the telephone number shown in the heading of this letter to discuss different methods of paying, such as in installments. If you don't enclose payment, we'll bill you for any unpaid amounts. Publication 594, *The IRS Collection Process*, is enclosed.

If you don't agree, you may request a meeting or telephone conference with the supervisor of the IRS contact identified in the heading of this letter. You also may file a protest with the IRS Appeals office by submitting a written request to the contact person at the address listed above within 30 calendar days from the date of this letter. The Appeals office is independent of the Exempt Organizations division and resolves most disputes informally.

For your protest to be valid, it must contain certain specific information, including a statement of the facts, the applicable law and arguments in support of your position. For specific information needed for a valid protest, please refer to page six of the enclosed Publication 3498. It also includes information on your rights as a taxpayer and the IRS collection process. Please note that Fast Track Mediation referred to in Publication 3498 generally doesn't apply after we issue this letter.

If you believe your disputed issue hasn't been addressed in published precedent or has been treated inconsistently by the IRS, you may request technical advice. If you'd like to know more about this process, please contact the individual identified on the first page of this letter. If you disagree with the technical advice decision, you may appeal that decision to the Appeals office, as explained above.

If we don't hear from you within 30 calendar days from the date of this letter, we'll issue a Statutory Notice of Deficiency based on the adjustments shown in the report of examination.

You have the right to contact the office of the Taxpayer Advocate. Their assistance isn't a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate can't reverse a legally correct tax determination, or extend the time fixed by law to file a petition in a United States court. They 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:

Internal Revenue Service
Office of the Taxpayer Advocate

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,



for Maria Hooke
Director, EO Examinations

Enclosures:

Report of Examination – Form 4621

Form 886-A, Explanation of Items

Form 4883, *Exempt Organizations Excise Tax Audit Changes*

Form 870-E, *Waiver of Restrictions on Assessment and Collection of Deficiency*

Publication 3498

Publication 594

Form 886-A (May 2017)	Department of the Treasury – Internal Revenue Service Explanations of Items	Schedule number or exhibit
Name of taxpayer	Tax Identification Number (last 4 digits)	Year/Period ended 6/30/20XX 6/30/20XX 6/30/20XX

Issues

1. Do funds from the _____ inure to and serve the private interests of Trustee, _____, in violation of the exemption requirements under Section 501(c)(3) of the Internal Revenue Code (Code)?
2. Does the _____ fail to meet the operational test under Section 501(c)(3) of the Code?
3. If the _____ fails to meet the operational test and pays funds over to private interests, should the exemption under Section 501(c)(3) of the Code be revoked?

Facts

(Trust) formed with a Declaration of Trust signed on June 26, 19XX. The Trust received a determination letter on March 11, 19XX granting exemption from federal tax under Section 501(a) of the Code as an organization described in Section 501(c)(3) of the Code and further classified as a private foundation.

Trust was formed to accept and hold property and distribute the income and/or principal to or for the use of charitable organizations and/or for charitable purposes within the meaning of Section 501(c)(3) of the Code. Trust also allows the income and/or principal be distributed to states, territories, or possessions of the United States, any political subdivision of any of the foregoing, or to the United States or the _____ but only for charitable purposes. Trust also states no part of the net earnings shall inure or be payable to or for the benefit of any private shareholder or individual.

The Declaration of Trust states the trust shall continue forever unless the trustees terminate it and distribute all of the principal and income, which action may be taken by the trustees in their discretion at any time. On such termination, the trust fund as then constituted shall be distributed to or for the use of such charitable organizations, in such amounts and for such charitable purposes as the trustees shall then select and determine.

Within Article Fifth of the Declaration of Trust, the number of trustees shall be at all times not less than two. Whenever for any reason the number is reduced to one, one or more additional trustees shall be appointed by the trustee or trustees by written instruments signed and acknowledged. The trustee or trustees, whether original or successor, shall have full authority to act even though one or more vacancies may exist.

Article Fifth continues in stating the trustees are authorized to pay to themselves amounts for reasonable expenses incurred and reasonable compensation for services rendered in the administration of the trust. In no event, however, shall any trustee who has contributed to the trust ever receive any compensation thereafter.

Form 886-A (May 2017)	Department of the Treasury – Internal Revenue Service Explanations of Items	Schedule number or exhibit
Name of taxpayer	Tax Identification Number (last 4 digits)	Year/Period ended 6/30/20XX 6/30/20XX 6/30/20XX

For the tax year ending June 30, 20XX, the Trust's Form 990-PF *Return of Private Foundation*, Part VIII listed two trustees: _____ and _____. The Trust filed Form 1099-MISC, *Miscellaneous Income*, for _____ for calendar years 20XX and 20XX reporting trustee fees of \$0 and \$0, respectively. The Trust calculates the trustee fees as a percentage of the asset base each year, which is typical in the industry.

The Trust's Form 990-PF for the tax year ending June 30, 20XX showed the following asset balances at the beginning of the year and at the end of the year:

	<u>Beg of Yr</u>	<u>End of Yr</u>
Cash	\$ 0	\$ 0
Savings	0	0
Equipment	0	0
Other notes and loans receivable	<u>0</u>	<u>0</u>
Totals	\$ 0	\$ 0

The Trust had no liabilities at the beginning or end of the tax year.

Part IX-A of the Trust's Form 990-PF described its activities as issuing college scholarships to qualified candidates. During the examination of the Trust's Form 990-PF for the tax year ended June 30, 20XX, the examiner confirmed this activity. The Trust pays full tuition to one or two recipients each year.

Part VII-B, line 1 of the Trust's Form 990-PF marked the box indicating that the trust had borrowed money from, lent money to, or otherwise extended credit to a disqualified person. Further, the return was marked that this act failed to qualify as an exception to the act of self-dealing as defined in the Regulations.

The Trust also filed a Form 4720, *Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code*, at the same time it filed the Form 990-PF for the tax year ended June 30, 20XX. This form described the act of self-dealing as "Loans from foundation to Trustee" with the date of the act stated as "various." The form calculated the act of self-dealing for both the disqualified person and the foundation manager. The amount involved for the self-dealing transaction correlated with the total amount of the note receivable shown on the Trust's return Form 990-PF: \$0. The Form 4720 included a statement that described the corrective action taken: "The foundation trustee borrowed \$0 from the trust. This amount was not repaid as of the end of the reporting period." An additional handwritten note printed in all capital letters stated: "Trustee has full intent and detailed plans for prompt repayment of all amount borrowed. (plus interest)."

During the examination of the Trust's Form 990-PF for the tax year ended June 30, 20XX, the examiner reviewed the accounting records and identified the following list of transactions under the category, Note Receivable from Trustee:

CHART DELETED

Form 886-A (May 2017)	Department of the Treasury – Internal Revenue Service Explanations of Items	Schedule number or exhibit
Name of taxpayer	Tax Identification Number (last 4 digits)	Year/Period ended 6/30/20XX 6/30/20XX 6/30/20XX

To this total, the accountant made the following adjustment in order to arrive at the \$0 note receivable amount used as the amount involved for the act of self-dealing shown on the Form 4720:

Total Amount from Note Receivable from Trustee category	\$	0
Less adjustment for mis-categorized rental exp (dtd 8/16/20XX)	(	0)
Less Trustee Fees (compensation) per filed Form 1099-MISC	(	0)
Total Self-Dealing transaction amount involved	\$	<u>0</u>

During the examination of the Trust's accounting books and records, the examiner expanded the review to include the subsequent tax year ending June 30, 20XX. The Trust has not filed a Form 990-PF for this tax year. The accounting records for this tax year also included the category, Note Receivable from Trustee; the transactions in this category for the tax year ended June 30, 20XX are as follows:

CHART DELETED

In correspondence dated July 20, 20XX, the Trustee explained an additional \$0 should be added to the Note Receivable from Trustee total. This amount is for attorney's fees incurred on December 15, 20XX originally charged as a Trust expense. The Trustee explained the discussions with the attorney were personal and regarding any legal consequence to her as a result of borrowing money from the trust. Since the discussions were on a personal level rather than about the Trust, she concluded the amount should be expensed to the Note Receivable from Trustee category.

The expanded review of the books and records included the calendar years of the disqualified person. Therefore, the review of the transactions continued to December 31, 20XX. On this date, the Trust had an ending balance of \$0. The transactions for the Note Receivable category listed in the accounting records for the period July 1, 20XX to December 31, 20XX are as follows:

CHART DELETED

With the adjustments for the mis-categorized rent expense in August 20XX and the additional expense for the personal attorney's fee in December 20XX, the total adjusted amount withdrawn and categorized as Notes Receivable from Trustee for the tax periods ending June 30, 20XX, June 30, 20XX, and December 31, 20XX, is as follows:

CHART DELETED

Form 886-A (May 2017)	Department of the Treasury – Internal Revenue Service Explanations of Items	Schedule number or exhibit
Name of taxpayer	Tax Identification Number (last 4 digits)	Year/Period ended 6/30/20XX 6/30/20XX 6/30/20XX

From this total, amounts paid as Trustee Fees (compensation) shown on the Form 1099-MISC for calendar years 20XX and 20XX are deducted. [No trustee fees were paid and no Form 1099-MISC was filed in calendar year 20XX.] Thus, the adjusted total amount for the Note Receivable from Trustee is below:

CHART DELETED

During the examination of the Trust's Form 990-PF for the tax year ended June 30, 20XX and the related filing of the Form 4720, the examiner determined the self-dealing transaction reported on the filed Form 4720 incorrectly used the tax year of the Trust, rather than the tax year of the disqualified person and the foundation manager. The correct tax year for the reporting of an individual's self-dealing transactions is the calendar year. Therefore, the Taxpayer and Foundation Manager agreed to file an amended Form 4720 to report the acts of self-dealing during the calendar year ending December 31, 20XX. The amendment not only corrected the tax year from the June 30, 20XX ending date to the December 31, 20XX ending date, but also correspondingly reduced the amount involved for both of the self-dealing acts reported on the original Form 4720 to reflect the withdrawals that occurred only in the 20XX calendar year. The new amount involved for the act of self-dealing was calculated for the amended return as follows:

CHART DELETED

is currently the sole trustee for the Trust; the second trustee shown on the Form 990-PF for the tax year ended June 30, 20XX resigned his position sometime after the end of the tax year. To date, the remaining sole trustee has not appointed a second trustee position. As the sole trustee, has unlimited and exclusive access to the Trust assets, including all banking, savings and investment accounts. records all Trust transactions in the accounting software,

recorded in the category she named Note Receivable from Trustee in the accounting each amount she withdrew for personal purposes. She also recorded additional amounts in this category for expenses incurred where she did not have sufficient documentation (such as a receipt) to substantiate a Trust expense for exempt purposes within the meaning of Section 501(c)(3) of the Code.

The following chart shows the category of distributions and expenses of the trust for the tax years ending June 30, 20XX and June 30, 20XX.

CHART DELETED

Form 886-A (May 2017)	Department of the Treasury – Internal Revenue Service Explanations of Items	Schedule number or exhibit
Name of taxpayer	Tax Identification Number (<i>last 4 digits</i>)	Year/Period ended 6/30/20XX 6/30/20XX 6/30/20XX

Law

Section 501(c)(3) of the Code provides, in part, exemption from federal income tax to organizations that are organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, as long as no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

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

Regulations Section 1.501(c)(3)-1(c)(1) states an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more exempt purposes specified in Section 501(c)(3) of the Code. The Regulations further clarifies that an organization will not be regarded as operated exclusively for exempt purposes if more than an insubstantial part of its activities is not in furtherance of exempt purposes.

Regulations Section 1.501(c)(3)-1(c)(2) further specifies 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.

Regulations Section 1.501(c)(3)-1(d)(1)(ii) provides that in order to meet the operational test, an organization must serve a public purpose rather than private interests. Thus, the organization must establish that it is not operated for the benefit of private interests such as designated individuals, the creator or his family, or the persons who directly or indirectly control the organization.

Regulations Section 1.501(a)-1(c) defines private shareholder or individual within this section 501 as persons having a personal and/or private interest in the activities of the organization.

Rev. Rul. 66-103, 1966-1 C.B. 134 holds that an organization whose primary activity is to provide awards and grants, including scholarship and fellowship grants, to needy individuals who would otherwise not be able to pursue their studies for lack of funds, qualifies for exemption under section 501(c)(3) of the Code. The organization is primarily engaged in a charitable activity of providing relief of the poor.

Rev. Rul. 69-257, 1969-1 C.B. 151 holds that an organization providing scholarships selected from a broad class of applicants on the basis of scholastic standing, qualifies for exemption under section 501(c)(3) of the Code. The organization is primarily engaged in the charitable activity of advancing education.

In *Better Business Bureau of Washington D.C., Inc. v United States*, 326 U.S. 279, 283 (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.

Form 886-A (May 2017)	Department of the Treasury – Internal Revenue Service Explanations of Items	Schedule number or exhibit
Name of taxpayer	Tax Identification Number (last 4 digits)	Year/Period ended 6/30/20XX 6/30/20XX 6/30/20XX

Government's Position

The Trust paid \$0 and \$0 in the tax periods ending June 30, 20XX and June 30, 20XX, respectively. These payments do not include the trustee's fees paid and reported on the Forms 1099-MISC for the calendar years 20XX and 20XX. These distributions to , at 0 percent and 0 percent of the total Trust expenses in each respective tax year, represent a substantial part of the total distributions paid out of the Trust each year.

In comparison, the Trust distributed \$0 and \$0 in scholarships in the tax periods ending June 30, 20XX and June 30, 20XX, respectively. The scholarship distributions represent the exempt use of the Trust funds. Yet the percentage of the total distributions for this exempt use of funds is only 0 percent and 0 percent for each tax year and only 0 percent as a total over the two tax years.

, as foundation manager and trustee, had control over the Trust accounts and books and approved all payments and withdrawals to herself. From July 2, 20XX until November 13, 20XX, she directly withdrew funds, wrote checks to herself, or paid unsubstantiated expenses from the Trust account in 0 separate transactions. She listed all of these transactions under the account she titled "Note Receivable from Trustee."

While the term "note receivable" may imply that the withdrawals are loans, has not signed any written agreement, note, or loan receivable/payable document with the Trust for any of the individual withdrawals or for a total of the withdrawals. and the Trust have not negotiated any interest rate or a stated repayment period. Therefore, regular withdrawals from the Trust are not a bona fide lending of money or loan with the Trust.

The Trust has not established that the payments to were made for any religious, charitable, educational, scientific or literary purposes. The payments to were not paid to an educational institution or as scholarship payments for educational purposes, which is the exempt purpose of the Trust.

The withdrawn amounts are also not compensation because , as trustee and foundation manager, received a trustee fee for the trust management services she provided. The trustee fees were reported on the Form 1099-MISC filed in the calendar years 20XX and 20XX. Adjustments were made to the Note Receivable from Trustee accounting category to reduce the totals in this category for the amounts considered paid to for the trustee fees.

Thus, the withdrawals and payments to are not an exempt use of funds; they were paid to serve her private interests. This violates the prohibition against the inurement of organizational funds to private individuals. Also, compared to the amount of scholarships paid for educational purposes, the payments to are more than an insubstantial part of the Trust's distributions. As a result, the Trust does not satisfy the operational test under Section 501(c)(3) of the Code.

Form 886-A (May 2017)	Department of the Treasury – Internal Revenue Service Explanations of Items	Schedule number or exhibit
Name of taxpayer	Tax Identification Number (last 4 digits)	Year/Period ended 6/30/20XX 6/30/20XX 6/30/20XX

With Trust funds inuring to the private benefit of an individual and the failure to meet the operational test under Section 501(c)(3) of the Code, the Trust's exemption should be revoked.

Taxpayer's Position

As noted on the filed Form 4720 and throughout the examination, _____ has stated that she intends to pay back the full amount withdrawn from the Trust plus interest. However, to date, she has not repaid any amounts to the Trust. _____ stated in correspondence received May 25, 20XX, that she has been writing a book and creating an enterprise. She asserts the proceeds from the sale of the book and the subsequent operation of the enterprise will have sufficient revenues so that she can eventually repay the Trust.

Conclusion

The Trust fails the operational test because a substantial part of its activities privately benefited and inured to an individual. Additionally, since the Trust has only \$0 remaining in the bank account, it cannot pay out any more scholarship distributions. The Trust is no longer conducting any exempt activities. As a result, the exemption for the Trust should be revoked. The effective date of the revocation is the first day of the tax year in which the Trust failed to meet the operational test. The distributions to _____ began in July 20XX, which is the first month of the tax year ending June 30, 20XX. Therefore, the effective date of the revocation is July 1, 20XX.