

Internal Revenue Service

Appeals Office

4330 Watt Ave SA 7890

Sacramento CA 95821-7012

Department of the Treasury

Taxpayer Identification Number:

Date: FEB 02 2015

Person to Contact:

Number: 201518021

Tel:

Release Date: 5/1/2015

Fax:

A

Tax Period(s) Ended:

B

Form Number

UIL: 501.03-00

Certified Mail

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, 2009.

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

Treas. Reg. section 1.501(c)(3)-1(a)(1) provides that in order to be exempt as an organization described in IRC section 501(c)(3), an organization must be both organized and operated exclusively for one or more exempt purposes. Your organization ceased operations in 2010, and your sole previous activity was the non-exempt activity of collecting on a note receivable and making payments to annuitants. You therefore failed to establish that you were engaged primarily in activities that accomplish one or more exempt purposes, and that you were not operated primarily for the benefit of private rather than public interests. Furthermore, you have agreed to revocation of your exempt status under section 501(c)(3).

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

You are required to file Federal income tax returns on Form 1120 for the tax periods stated in the heading of this letter and for all tax years thereafter. 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 revocation, 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.

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.

You have waived your right to contest this determination under the declaratory judgment provisions of Section 7428 of the Code by your execution of Form 906, *Closing Agreement Concerning Specific Matters*, an executed copy of which is being sent to you under separate cover.

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

Sincerely Yours,

A handwritten signature in black ink, appearing to read "Nan Shimizu", written in a cursive style.

Appeals Team Manager
Nan Shimizu

Internal Revenue Service
Tax Exempt and Government Entities Division
Exempt Organizations: Examinations

Department of the Treasury

UIL: 501.03.31

Date: July 12, 2013

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Manager's Name/ID Number:

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,

Nanette M. Downing
Director, EO Examinations

Enclosures:
Report of Examination
Form 870-E
Publication 3498
Publication 594

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer	TIN	Year/Period Ended
ORG		12/31/20XX
		12/31/20XX
		12/31/20XX

LEGEND

ORG - Organization name XX - Date State - state President - president
 Vice President - vice president Vice President-2 - Vice President-2
 Secretary/Treasurer - secretary/treasurer Attorney - attorney
 Annuitants - annuitants Operator - operator

Issue #1 Revocation:

Whether ORG (ORG), continues to qualify for exemption under Section 501(c)(3) of the Internal Revenue Code.

Issue #2 Private Foundation Status:

Whether ORG should be reclassified as a private foundation making it liable for tax on undistributed income under Section 4942 of the Internal Revenue Code.

Facts:

ORG was originally formed as ORG (ORG). Articles of incorporation were filed for ORG on May 7, 19XX. The Internal Revenue Service issued a determination letter in October of 19XX recognizing ORG as a 501(c)(3) public charity described in section 509(a)(1) and 170(b)(1)(A)(vi) of the code. Article IV of ORG's articles of incorporation listed the following proposed activities:

1. The stimulation, support and development of a better understanding of the disease of cancer and its effect on people within the State of State
2. The encouragement and maintenance of exchange of ideas and methods of rehabilitation of, and therapy for cancer patients
3. The promotion of effective counseling programs for cancer patients and their families
4. The provision of essential transportation for cancer therapy patients and their families
5. The provision of necessary equipment aids for cancer patients such as beds, wheelchairs, commodes, walkers, etc. whenever available
6. The dissemination of information concerning cancer and rehabilitation of cancer patients, not only to cancer patients but also to physicians, business and professional people and others who are in a position to assist in the rehabilitation of cancer patients, and
7. The function as a source of support and encouragement to those who must undergo cancer treatment, both before and during the course of rehabilitation.

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		12/31/20XX

The State Corporation Commission received an amendment to the articles of incorporation on December 10, 19XX. The amendment changed the name of ORG to ORG and appointed new officers. The new officers were listed as follows: President – President, Vice President – Vice-President, Vice President-2 – Vice-President, and Secretary/Treasurer – Secretary/Treasurer. The new officers were also appointed as directors and Vice President-2 was also designated as the new statutory agent. Article IV of the articles of incorporation was amended to describe ORG's activities as follows:

1. The stimulation, support, development and perpetuation of traditional American family values.
2. The encouragement, support and maintenance of non-profit organizations advancing health and health research related issues, education and the arts, relief of suffering, etc.
3. The dissemination of information leading to an increase in the number of American families managing their "social capital."
4. The promulgation of a charitable gift annuity program, allowing families and business owners to participate in planned giving.
5. The maintenance of a donor advised account program, allowing families the opportunity to establish a "social legacy", whereby the family can support selected charities on a continuing basis.

The new officers began to market charitable gift annuities through ORG. The annuities promised tax advantages to the purchaser, annuity payments to a lifetime beneficiary and any residual would go to a public charity. Most of the annuities were not properly secured or insured and funds raised through them were ultimately used by the officers for operating costs. ORG relied on new investors to make payments on the annuities sold to previous investors.

ORG began to have trouble making annuity payments and in 20XX filed for Chapter 11 bankruptcy. In 20XX it emerged from bankruptcy and hired Attorney as general legal counsel. At that time ORG tried to resume its prior business of offering charitable gift annuities. This proved to be impossible because of the bankruptcy on its record. By July of 20XX it was inevitable that ORG would need to be shut down.

Since shutting down ORG would immediately end all annuity payments, Attorney volunteered to run ORG at no charge so that annuity payments could continue for as long as possible. On July 7, 20XX Attorney was named ORG's president, CEO, statutory agent, and chairman of the board as its sole director.

The bankruptcy resulted in a note payable from CO-1 (CO-1) to ORG. At the time of ORG's bankruptcy, CO-1 was operated by Operator and three ORG officers;

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President, Vice President, and Secretary/Treasurer. The principal of the note was \$. Payments were to be made in 60 equal installments of \$ which included principal and interest. Payments were to begin on January 15, 20XX and would occur on the 15th day of each month thereafter.

ORG has not issued any charitable gift annuities since Attorney took over in 20XX. Since Attorney's involvement, ORG's activity was limited to receiving payments on the note payable from CO-1. ORG used these funds to pay annuitants. Bank statements, canceled checks, and electronic withdrawals reviewed for the 20XX year confirm that substantially all withdrawals went to annuitants. Form 1099R was issued to all annuitants who received annuity payments in 20XX. ORG was able to provide an annuity contract for all individuals who received a 1099R.

CO-1 stopped making payments on the note payable in the first half of 20XX. This was ORG's only source of income. Once payments on this note stopped, ORG could no longer make annuity payments. ORG has not made an annuity payment since June of 20XX. ORG estimates that it is still owed over \$ on the note payable.

ORG does not conduct any charitable programs or activities. As stated earlier, the only activity that has taken place since 20XX is the collecting of payments on the CO-1 note payable and using the funds to make annuity payments. ORG's Form 990 return filed for the 20XX year reports grants and other assistance of \$ on Line 1 of Part IX. This was supposedly a disbursement to a 501(c)(3) entity. However, review of canceled checks and electronic withdrawals revealed no such charitable disbursement.

ORG incorrectly listed publicly traded securities with a year-end value of \$ on its 20XX Form 990 return. ORG does not hold any publicly traded securities. The examination revealed that these are annuity and life insurance policies. These policies were not reported using their 12/31/20XX cash surrender values and as such are grossly overstated on the Form 990 return. The value of these policies as of December 31, 20XX was approximately \$.

The majority of these annuities are written on the Annuitants; the largest investor of ORG charitable gift annuities. They invested about \$. Through bankruptcy it was held that these annuities could only be used to pay the Annuitant family. As such, ORG cannot use these annuities to pay any other annuitants. Upon the death of the Annuitants most of the residuum of the policies is set to go to public charities. If there are any funds left over the residuum amount dedicated to charity, ORG will use those funds to continue annuity payments.

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		12/31/20XX

A letter and information document request was sent to ORG on January 4, 20XX. The purpose of this letter was to obtain the value of the annuities and life insurance policies as of December 31, 20XX. On January 15, 20XX Appointee, appointee of ORG, called and requested additional time to gather the requested information. She also explained that the figure would not be much different from the December 31, 20XX value already obtained. An extension was granted until February 13, 20XX. ORG did provide information to show the value of some of its annuities and life insurance policies as of December 31, 20XX. However, information for all policies was not provided.

20XX was the last year that ORG filed a 990 return. This return did not list any charitable mission or any program service accomplishments. Attorney confirmed that ORG does not currently conduct any activities. He stated that he has kept ORG running primarily with the hopes that it may be able to resume making payments to annuitants at a future date.

Part III of Schedule A of ORG's 20XX 990 return reports public support of \$ which was received in the 20XX year. No other sources of public support were reported on the Schedule A. Total support is also reported as \$ which was received in the 20XX year. Section C of Part III reports ORG's public support as 100%.

Law:

Issue #1: Revocation

Section 501(c)(3) of the Internal Revenue Code (IRC) exempts from federal income tax organizations organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, educational purposes, to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals, provided that no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Federal Tax Regulations (Regulations) provides that in order to be exempt as an organization described in section 501(c)(3) of the Code, the organization must be one that is both organized and operated exclusively for one or more of the purposes specified in that section.

Section 1.501(c)(3)-1(c)(1) of the Regulations provides 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.

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		12/31/20XX

Section 1.501(c)(3)-1(d)(l)(ii) of the Regulations provides that to meet the operational test, an organization must be engaged in activities furthering "public" purposes rather than private interests. It must not be operated for the benefit of designated individuals or the persons who created it.

Issue #2: Private Foundation Status

Section 509(a) of the (IRC) provides that the term "private foundation" means a domestic or foreign organization described in section 501(c)(3) other than –

- 1) an organization described in section 170(b)(1)(a) (other than clauses (vii) and (viii));
- 2) an organization that normally receives more than one third of its support from contributions, membership fees, and gross receipts from activities related to its charitable, etc., functions – subject to certain exceptions, and no more than one third of its support from gross investment income and unrelated business taxable income (less section 511 tax) from businesses acquired by the organization after June 30, 19XX;
- 3) an organization that is not controlled by any disqualified persons (other than foundation managers) and supports organizations described in sections 509(a)(1) or (2) or section 501(c)(4), (5), or (6), if they meet the tests of section 509(a)(2); and
- 4) an organization organized and operated to test for public safety.

Sections 170(b)(1)(A)(vi) and 509(a)(1) of the IRC describe an organization "...which normally receives a substantial part of its support from a governmental unit... or from direct or indirect contributions from the general public.

Section 509(a)(2) of the IRC describes an organization that normally receives no more than one-third of its support from gross investment income and more than one-third of its support in each tax year from any combination of the following:

- i) gifts, grants, contributions, or membership fees, and
- ii) gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in an activity which is not an unrelated trade or business (to the extent that gross receipts from any person, or from any bureau or similar agency of a governmental unit do not exceed the greater of \$5,000 or 1 percent of the organization's total support in that year).

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		12/31/20XX

Section 1.170A-9(e)(2) of the Regulations states that an organization is publicly supported if at least 33 1/3 percent of its support is received from governmental units and direct or indirect contributions from the general public.

Section 1.170A-9(e)(3)(i) of the regulations provides that the percentage of support "normally" received by an organization from governmental units, from contributions made directly or indirectly by the general public, or from a combination of these sources, must be "substantial." For purposes of this subparagraph, an organization will not be treated as "normally" receiving a "substantial" amount of governmental or public support unless the total amount of governmental and public support "normally" received equals at least 10 percent of the total support "normally" received by such organization.

Section 1.509(a)-3(m) of the regulations provides, "if such organization also furnishes facilities or loans to persons who are not members of such class and such furnishing does not contribute importantly to the accomplishment of such organization's exempt purposes (aside from the need of such organization for income or funds or the use it makes of the profits derived), the support received from such furnishing will be considered 'rents' or 'interest' and therefore will be treated as 'gross investment income' within the meaning of section 509(d)(4), unless such income is included in computing the tax imposed by section 511."

Sections 1.170A-9(f)(4)(vii)(B) and 1.509(a)-3(c)(1)(i) of the regulations provide that an organization that has failed to qualify under 170(b)(1)(A)(vi) or 509(a)(2) for any two consecutive taxable years will be treated as a private foundation as of the first day of the second consecutive taxable year only for purposes of sections 507, 4940, and 6033. Such an organization must file a Form 990-PF, "Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation," and will be liable for the net investment tax imposed by section 4940 and, if applicable, the private foundation termination tax imposed by section 507(c), for that second consecutive failed year. For the succeeding years, the organization will be treated as a private foundation for all purposes.

Section 4942(a) of the IRC provides that there is hereby imposed on the undistributed income of a private foundation for any taxable year, which has not been distributed before the first day of the second (or any succeeding) taxable year following such taxable year (if such first day falls within the taxable period), a tax equal to 30 percent of the amount of such income remaining undistributed at the beginning of such second (or succeeding) taxable year.

Section 4942(b) of the IRC provides that in any case in which an initial tax is imposed under subsection (a) on the undistributed income of a private foundation for any taxable year, if any portion of such income remains undistributed at the close of the taxable

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period, there is hereby imposed a tax equal to 100 percent of the amount remaining undistributed at such time.

Section 4942(c) of the IRC provides that the term "undistributed income" means, with respect to any private foundation for any taxable year as of any time, the amount by which –

- 1) the distributable amount for such taxable year, exceeds
- 2) the qualifying distributions made before such time out of such distributable amount.

Section 4942(d) of the IRC provides that the term "distributable amount" means, with respect to any foundation for any taxable year, an amount equal to –

- 1) the sum of the minimum investment return plus the amounts described in subsection (f)(2)(C), reduced by
- 2) the sum of the taxes imposed on such private foundation for the taxable year under subtitle A and section 4940.

Section 4942(e) of the IRC provides that the minimum investment return for any private foundation for any taxable year is 5 percent of the excess of –

- A) the aggregate fair market value of all assets of the foundation other than those which are used (or held for use) directly in carrying out the foundation's exempt purpose, over
- B) the acquisition indebtedness with respect to such assets (determined under section 514(c)(1) without regard to the taxable year in which the indebtedness was incurred).

Section 4942(j)(1) of the IRC provides that the term "taxable period" means, with respect to the undistributed income for any taxable year, the period beginning with the first day of the taxable year and ending on the earlier of –

- A) the date of mailing of a notice of deficiency with respect to the tax imposed by subsection (a) under section 6212, or
- B) the date on which the tax imposed by subsection (a) is assessed.

Taxpayer's Position:

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		12/31/20XX
		12/31/20XX

Issue #1: Revocation

ORG accepts and does not protest change to the revocation of exemption under IRC § 501(c)(3) effective January 1, 20XX.

Issue #2: Private Foundation Status

ORG does not accept the government's position regarding this issue and submitted a valid protest challenging this issue. ORG's position is that tax exempt organizations under IRC section 501(c)(3) may be either a "publicly supported organization" or a "private foundation" under applicable provisions of IRC sections 509(a)(1) and 170(b). To be either a "publicly supported organization" or a "private foundation" under applicable provisions of IRC sections 509(a)(1) and 170(b), the organization must first be a tax exempt organization under IRC section 501(c)(3). Organizations that do not qualify as tax exempt under IRC section 501(c)(3) also do not qualify as either public or private charities under IRC sections 509(a)(1) and 170(b). As a matter of law organizations that are not tax exempt under IRC sections 501(c)(3) cannot be "private foundations" under IRC sections 509(a)(1) and 170(b). Organizations that are not "private foundations" are not subject to the private foundation excise tax under Chapter 42 of the IRC.

Government's Position:

Issue #1: Revocation

ORG has been inactive since Attorney took over in 20XX. Since then ORG's sole activity has been to collect payments on a note payable from CO-1 and use these funds to pay annuitants. This in and of itself is not a charitable purpose described in section 501(c)(3) of the Code. CO-1 stopped paying on the note in 20XX and because of this ORG has not made an annuity payment since June of 20XX. ORG has not conducted any activities since June of 20XX.

ORG is inactive and does not conduct any activities and therefore fails the operational test as required by section 1.501(c)(3)-1(a)(1) of the regulations. ORG cannot be operating for 501(c)(3) purposes if it has no activities.

ORG reported \$ of grants and other assistance on its 20XX Form 990 return. Review of canceled checks and electronic withdrawals did not reveal payments to any charities. This \$ could not be confirmed to be for charitable purposes. Even if this could be confirmed to be a charitable disbursement, it is not a substantial enough activity to prevent revocation of ORG's tax-exempt status. ORG has not filed

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		12/31/20XX

a Form 990 return for 20XX or 20XX. Because it did not have any income since early 20XX, there would have been no funds for charitable disbursements since then. If the \$ was for charitable distributions, it would still be the only charitable disbursements made in a three year period. This further demonstrates the inactivity of ORG.

Issue #2: Private Foundation Status

ORG is not a publicly supported entity and does not qualify as a publicly supported entity described in Section 509(a)(2) of the IRC. ORG failed to report all of its sources of support on Schedule A. Specifically, ORG did not include investment income as part of its total support. When investment income is included in the support calculation it is clear that ORG fails the 33 1/3% public support requirement. See the attachment titled "Private Foundation Status" for an explanation of how ORG's public support was calculated.

As can be seen from the calculation ORG's public support is only 17.11% for the 2005-20XX period. The public support calculation is also likely higher than what it really is. Figures were taken from ORG's previous 990 returns to calculate public support. The 20XX Form 990 reported \$ of direct public support on Part 1, line 1b. The 20XX return reports \$ of direct public support. It is not known what generated these figures. Attorney stated that since he took over in 20XX, ORG had no activities other than collecting payments from CO-1 which were used to make payments to annuitants. If this statement is correct, it is likely that the direct public support reported in 20XX and 20XX do not actually constitute a source which would be classified as direct public support. Payments from CO-1 would not constitute a source of public support.

ORG fails the public support test and will be treated as a private foundation as described in Regulations 1.170A-9(f)(4)(vii)(B) and 1.509(a)-3(c)(1)(i).

As a private foundation ORG would be required to make distributions to accomplish a charitable purpose. In 20XX ORG only had \$ of qualifying distributions. However, ORG was required to make distributions of \$. Any undistributed amount would become taxable at the end of 20XX under section 4942(a) of the IRC. ORG is liable for \$ of tax under section 4942(a) of the IRC for the 20XX year. ORG did not file Form 990 or 990-PF for the 20XX year and it is assumed there were no qualifying distributions since they were no longer operational at this point. However ORG still held largely the same assets as it did for the 20XX year. In 20XX ORG was required to make distributions of \$. ORG is liable for \$ of tax under section 4942(a) of the IRC for the 20XX year. Both the 20XX and 20XX section 4942(a) tax would

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		12/31/20XX

ultimately be due in 20XX. See the attachments titled "Tax on Undistributed Income" to see how the tax liability was calculated.

ORG has not distributed all of its required distributions for either the 20XX or 20XX year. Section 4942(b) of the IRC imposes a tax equal to 100 percent of the amount of undistributed income remaining undistributed at the close of the taxable period. Remaining undistributed income is \$ for the 20XX year and \$ for the 20XX year. ORG must distribute this income by the end of the taxable period or it will be subject to the 100 percent tax. The total tax under section 4942(b) is \$.

Conclusion:

Issue #1: Revocation

ORG is not organized and operated exclusively for charitable purposes as required by Section 501(c)(3) of the Internal Revenue Code. ORG's tax-exempt status should be revoked.

Issue #2: Private Foundation Status

ORG did not qualify as a publicly supported charity and should be a private foundation. As a private foundation ORG is liable for \$ of tax on undistributed income under section 4942(a) of the IRC. If ORG does not distribute the remaining undistributed income from 20XX and 20XX they will be liable for the 100 percent tax under 4942(b) which is \$.