DEPARTMENT OF THE TREASURY



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Number: 201522006

Release Date: 5/29/2015

:

Internal Revenue Service TE/GE EO Examinations 1100 Commerce Street Dallas, TX 75242

Date: February 25, 2015

Person to Contact:

Identification Number:

Contact Telephone Number:

In Reply Refer to: TE/GE Review Staff

EIN:

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 as to your exempt status under section 501(c)(3) of the Internal Revenue Code. Your exemption from Federal income tax under section 501(c)(3) of the code is hereby revoked effective January 1, 20XX.

Our adverse determination was made for the following reasons:

You have not demonstrated that you are operated exclusively for charitable, educational, or other exempt purposes within the meaning of I.R.C. section 501(c)(3). You have failed to produce documents or otherwise establish that you are operated exclusively for exempt purposes and that no part of your net earnings inures to the benefit of private shareholders or individuals. You failed to keep adequate books and records as required by I.R.C. § 6001, 6033(a)(1) and Rev. Rul. 59-95, 1959-1 C.B. 627.

Contributions to your organization are no longer 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 December 31, 20XX 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.

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.

You also have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers.

You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling, Tel:

or write:

Taxpayer Advocate

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

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,

Margaret Von Lienen Director, EO Examinations

Enclosure: Publication 892

Internal Revenue Service
Tax Exempt and Government Entities Division
Exempt Organizations: Examinations
12309 North MOPAC Expressway
Austin, TX 78758

Department of the Treasury

Date:

July 2, 2014

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

Why you are receiving this letter

We propose to revoke your status as an organization described in section 501(c)(3) of the Internal Revenue Code (Code). Enclosed is our report of examination explaining the proposed action.

What you need to do if you agree

If you agree with our proposal, please sign the enclosed Form 6018, Consent to Proposed Action-Section 7428, and return it to the contact person at the address listed above (unless you have already provided us a signed Form 6018). We'll issue a final revocation letter determining that you aren't an organization described in section 501(c)(3).

After we issue the final revocation letter, we'll announce that your organization is no longer eligible for contributions deductible under section 170 of the Code.

If we don't hear from you

If you don't respond to this proposal within 30 calendar days from the date of this letter, we'll issue a final revocation letter. Failing to respond to this proposal will adversely impact your legal standing to seek a declaratory judgment because you failed to exhaust your administrative remedies.

Effect of revocation status

If you receive a final revocation letter, you'll be required to file federal income tax returns for the tax year(s) shown above as well as for subsequent tax years.

What you need to do if you disagree with the proposed revocation

If you disagree with our proposed revocation, 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 one of the enclosed Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*, and page six of the enclosed Publication 3498, *The Examination Process*. Publication 3498 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.

You also may request that we refer this matter for technical advice as explained in Publication 892. Please contact the individual identified on the first page of this letter if you are considering requesting technical advice. If we issue a determination letter to you based on a technical advice memorandum issued by the Exempt Organizations Rulings and Agreements office, no further IRS administrative appeal will be available to you.

Contacting the Taxpayer Advocate Office is a taxpayer right

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 you have (fixed by law) to file a petition in a United States court. They can, however, see that a tax matter that hasn't 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

For additional information

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.

Barbara L. Harris Acting Director, EO Examinations

Enclosures: Report of Examination Form 6018 Publication 892 Publication 3498

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

ISSUES

- 1. Whether should have their exemption revoked for creating private benefit and inurement to the corporate officers of the exempt organization?
- Whether should be revoked due to no exempt purpose.

FACTS

originally located at is a corporation granted section 501(c)(3) exemption on April 29, 19XX. is a Hippo therapy facility. Hippo therapy is a form of physical, occupational and speech therapy in which a therapist uses the characteristic movements of a horse to provide carefully graded motor and sensory input. was started by the family that started the charity.

is a qualified 501(c)(3) that held a mortgage on about 40 acres of land that housed a horse arena and a large barn. sold the majority of it's assets to another exempt organization during the year ending December 31, 20XX. A Warranty Deed with Vendor's Lien for \$ was issued from the new exempt organization to for the above stated property. sold its interest in the property and facilities to . The original mortgage was paid. The inurement amount identified by this agent is \$ as per the chart provided below.

An agreement concerning the Intent of Reverter Clause was created between and . This agreement states as long as a section 501(c)(3) with a functioning board of directors and a licensed and/or certified therapist uses the facilities for Animal Assisted Therapy (Hippo therapy) the property will not revert back to . The agreement also states the property itself can not be used as collateral for future capital or loans.

filed returns for the following years 20XX, 20XX, 20XX, 20XX, and 20XX. The 20XX return showed a beginning equity balance of \$. The ending equity balance on the 20XX return shows a balance of zero. The return shows no expenses to change the equity balance. No returns were filed after the period ending December 31, 20XX. would Terminate its exemption in February of 20XX.

The return states in Part V line 38a that the organization did not borrow from, or make any loans to, any officer, director, trustee. Or were any such loans made in prior year and still outstanding at the end of the year covered by this return.

The return also states in Part V line 40b that as a Section 501(c)(3) organization it did not engage in any section 4958 excess benefit transaction during the year, or did not engage in an excess benefit transactions in the prior years that were not reported on

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any prior Form 990 or 990-EZ. Also in line 40c the form states that no amount of tax was self imposed by the organization for section 4958 transactions.

Schedule O states," This entity will continue to operate as a tax-exempt entity, involved with dog therapy only."

Schedule O also states, "This tax-exempt entity sold all of the assets involved with their horse therapy to , on October 13, 20XX. is a 501(c)(3) tax exempt organization, operating within the same exempt purpose as this entity.

This note, in the original amount of \$\text{ was scheduled be paid over a 10 year period. The note referred to on Schedule O was paid in full on October 4, 20XX. The check # was a payoff of the loan in full that cleared the bank on October 13, 20XX. The return that these statements are included on was filed on July 01, 20XX. The return was filed by

IDR #1 was sent to on March 8, 20XX, it asked for all financial records for during the year ending December 31, 20XX.

IDR #2 was sent to on April 26, 20XX, it also asked for all financial records for during the year ending December 31, 20XX.

sent a statement that said, "The year in question 20XX was completely no activity." In the next correspondence from The Executive Director the following work history was provided from the Executive Director: "1/20XX thru 5/20XX Worked with 4 to 5 emotionally disturbed students weekly out of ... Horse and dog therapy were used in these counseling sessions." In the first correspondence received from the Executive Director the following statement was received, "Enclosed is the documents associated with the closing + transfer of my business to ... I could not start a new business nor work in horse therapy for 5 years after 20XX. I did some animal assisted therapy following XX using the dog for ..."

All records provided from Information Document Requests were from the year ending December 31, 20XX. The Executive Director provided no records from the period under exam. The Executive Director of in a hand written note to this agent wrote, "The year in question 20XX was completely no activity."

In the next correspondence from The Executive Director the following

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The following chart shows the payments received by 20XX & December 31, 20XX.

between January 1,

		DATE OF			No. of Contract of
	NAME ON CHECK	CHECK	CHECK#	AMOUNT	
		12/31/20XX	3005		
AMMAN AMMAN TO S.	"The annual control of the	1/31/20XX	3031		
7		2/28/20XX	3053		
		3/31/20xx	3083		
		4/30/20XX	3104		
		5/31/20XX	3149		
		6/30/20XX	3182		
		10/4/20XX	Bernard control on the second control of the		
	4	of the second and an annual second and an annual second			

These checks were cut by note payable to

an applicable Section 501(c)(3) to pay for a for the facilities purchased from

<u>LAW</u>

Section 501(c)(3) of the Code exempts from federal income tax organizations organized and operated exclusively for charitable, educational, and other exempt purposes, provided that no part of the organization's net earnings incres to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the 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.

Section 1.501(c)(3)-1(d)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

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Section 1.501(c)(3)-1(d)(1)(ii) of the regulations states that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. The regulation places the burden of proof on the organization to demonstrate 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 includes the promotion of education.

The presence of a single substantial nonexempt purpose can destroy the exemption regardless of the number or importance of exempt purposes. *Better Bus. Bureau v. United States, 326 U.S. 279. 283, 90 L. Ed. 67, 66 S. Ct. 112 (1945); Am. Campaign Acad. v. Commissioner, 92 T.C. 1053, 1065 (1989); see also Old Dominion Box Co., Inc. v. United States, 477 F2d. 340 (4th Cir. 1973), cert. denied, 413 US 910 (1973) ("operating for the benefit of private parties who are not members of a charitable class constitutes a substantial nonexempt purpose"). When an organization operates for the benefit of private interests, such as designated individuals, the creator or his family, or persons directly or indirectly controlled by such private interests, the organization by definition does not operate exclusively for exempt purposes. <i>Am. Campaign Acad. v. Commissioner, supra at 1065-1066.*

In *B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978)*, the courts ruled the organization did not qualify for exemption under IRC section 501(c)(3) because it was not operated exclusively for charitable, educational, or scientific purposes.

In order to be recognized as exempt under IRC section 501(c)(3), the organization is prohibited from:

- 1) permitting its net earnings to inure to the benefit of private individuals or operating in a way where more than an insubstantial part of its activities further private versus public purposes
- 2) engaging substantially in legislative activity
- 3) participating or intervening in any political activity

Treas. Reg. section 1.501(c)(3)-1(c)(2) states that an organization is not exclusively operated for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Treas. Reg. section 1.501(a)-1(c) defines a "private shareholder or individual" as "persons having a personal and private interest in the activities of an organization."

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If the private benefit to an individual or a group of individuals is greater than the public benefit, the private benefit is considered substantial. A substantial private benefit can result in revocation of exempt status.

Even a small amount of private inurement is fatal to exemption. In *Spokane Motorcycle Club v. U.S., 222 F. Supp. 151 (E.D. Wash. 1963*), net profits were found to inure to private individuals where refreshments, goods and services amounting to \$825 (representing some 8% of gross revenues) were furnished to members

Regs. 1.501(c)(3)-1(d)(1)(ii) states that the burden of proof is upon the organization to establish that it is not organized or operated for the benefit of private interests. This requirement applies equally to inurement and private benefit issues. While it is difficult to prove a negative, the organization is certainly in a better position than the Service to know the detailed facts surrounding its formation and operation. Therefore, in an exemption application case the organization is required to furnish the Service with the documents setting forth its purposes and rules of operation as well as a detailed explanation of its operations. See Rev. Proc. 84-46, 1984-1 C.B. 541.

In John Marshall Law School and John Marshall University v. United States, 228 Ct. Cl. 902 (1981), 81-2 U.S.T.C. 9514 involve classic channeling of an organization's net earnings to those in control. The court sustained the Service's revocation of the school's exempt status based on inurement. The court found inurement existed when the school provided the following to family members who were its officers:

- * Interest free loans
- Unsecured loans
- * Payments for non-business travel
- * Payments for non-business entertainment
- * Personal health spa membership

In *United Cancer Council, Inc. v. Commissioner, 165 F.3d 1173 (1999)*, the appeals court stated the inurement clause of IRC section 501(c)(3) interprets the phrase "private individual or shareholder" as an insider of the charity.

The court further said a charity must not improperly pass its earnings to its founder, board members, their families, or anyone else described as an insider who is the equivalent of an owner or manager. The insider could be an employee such as an office manager.

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GOVERNMENT'S POSITION

An organization recognized as exempt under IRC section 501(c)(3) is prohibited from permitting any of its net earnings to inure to the benefit of any private shareholder or individual

sent a statement that said, "The year in question 20XX was completely no activity." In the second correspondence from The Executive Director the following work history was provided from the Executive Director: "1/20XX thru 5/20XX Worked with 4 to 5 emotionally disturbed students weekly out of ... Horse and dog therapy were used in these counseling sessions." In the first correspondence received from the Executive Director the following statement was received, "Enclosed is the documents associated with the closing + transfer of my business to ... I could not start a new business nor work in horse therapy for 5 years after 20XX. I did some animal assisted therapy following XX using the dog for ... " These written statements completely contradict each other. The first information received by this agent before the Section 4958 assessment was issued. The second correspondence from the Executive Director after the Section 4958 assessment was issued.

Regs. 1.501(c)(3)-1(d)(1)(ii) states that the burden of proof is upon the organization to establish that it is not organized or operated for the benefit of private interests. This requirement applies equally to inurement and private benefit issues. While it is difficult to prove a negative, the organization is certainly in a better position than the Service to know the detailed facts surrounding its formation and operation. Therefore, in an exemption application case the organization is required to furnish the Service with the documents setting forth its purposes and rules of operation as well as a detailed explanation of its operations. See *Rev. Proc.* 84-46, 1984-1 C.B. 541.

Just like John Marshall Law School and John Marshall University the officers of channeled the funds created from the sale of the facilities owned by

The proceeds from the sale were diverted for personal use just as in *United Cancer Council, Inc. v. Commissioner, 165 F.3d 1173 (1999).* The funds were received by

the funds were used by the Executive Director to build an new barn on the Executive directors personal property. The dates provided for this activity were October 20XX to February of 20XX.

stated that they had not received any revenues on their return during the year ending December 31, 20XX. stated on their 20XX return received on July 4, 20XX that the loan was to be paid off over a 10 year period, but the loan had already been paid during the 20XX year. No revenues were disclosed to the Government by on the Form 990. No revenues were disclosed to the Government during the exam process. Two IDRs were sent requesting all financial

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information for the year 20XX. The Executive Director sent a note stating that absolutely no revenues were received in the year 20XX. The Executive Director indicated that there was no existing bank account for

In the case of it is the service's position that the private individual's benefit is substantial and with no exempt purpose the private benefit to an individual or a group of individuals is greater than the public benefit. There was no public benefit presented by for the year under exam. has not performed any exempt function from the beginning of 20XX to present. This instance private benefit is considered the only function presented by the exempt organization. Therefore, it is the services position that exempt status must be revoked.

It is the Government's position that the Executive Director has not provided any consistency in the information provided in this examination.

CONCLUSION

Regs. 1.501(c)(3)-1(d)(1)(ii) states that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. The regulation places the burden of proof on the organization to demonstrate 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. This agent asked

about its revenues and activities during the year ending December 31, 20XX and indicated there were no activities, nor was there any revenues received by the exempt organization. would Terminate its exemption in February of 20XX.

Based on the foregoing reasons, the organization does not qualify for exemption under section 501(c)(3) and its tax exempt status should be revoked as of January 1 20XX.

should have their exempt status revoked due to lack of exempt purposes and no activities. There were no exempt activities were performed during the year under exam.

TAXPAYER'S POSITION

position is that they did not do anything wrong.