

Internal Revenue Service
Appeals Office
1375 E. Ninth Street
One Cleveland Center #815
Cleveland, OH 44114-1739

Number: **201052022**
Release Date: 12/30/2010

Date: October 5, 2010

A
B

Certified Mail

Dear :

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC). It is determined that you do not qualify as exempt from Federal income tax under IRC Section 501(c)(3) effective December 22, 2000. Your application for exemption (Form 1023) and associated materials misstated material facts, and you operated in a manner materially different than originally represented.

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

You are not operated exclusively for exempt purposes described in I.R.C. § 501(c)(3) for the following reasons:

- (1) Your net earnings inured to the benefit of your founder Trustees within the meaning of Treas. Reg. § 1.501(c)(3)-1(c)(2).
- (2) You operated for the private benefit of individuals including your creators, Trustees, and entities your Trustees own or control, as more than an insubstantial part of your activities, within the meaning of Treas. Reg. § 1.501(c)(3)-1(c)(1) and (d)(1)(ii).

In the event there is a final order from a court of competent jurisdiction finding that you were in fact described in section 501(c)(3), then we are alternatively

Department of the Treasury

Person to Contact:

Employee ID Number:

Tel:

Fax:

Refer Reply to:

In Re:

Form Required to be Filed:

EIN:

Tax Period(s) Ended:

UIL:

501.03-05

determining you are a private foundation described in section 509(a) rather than a supporting organization described in section 509(a)(3) for the following reasons:

- (1) You failed the operational test described in Treas. Reg. § 1.509(a)-4(e) by making 20 percent of your grants to organizations other than the supported organizations specified in your Declaration of Trust.
- (2) You failed the control test described in I.R.C. § 509(a)(3)(C) and Treas. Reg. § 1.509(a)-4(j)(1) because A ("A") primary assets, held by D, were under the sole management of A's founders and Trustees, requiring no input from the other Trustees. Thus, these disqualified persons could and did require A to perform acts that significantly affected its operations without the votes of the remaining Trustees and, as such, these disqualified persons had control over A.
- (3) Because E and F, in fact, controlled A, A was not "operated, supervised, or controlled by" or "supervised or controlled in connection with" its supported organizations and was also not "operated in connection with" its supported organizations; as such, A failed the relationship test described in Treas. Reg. § 1.509(a)-4(f).
- (4) A failed the organizational test described in Treas. Reg. § 1.509(a)-4(c) because its Declaration of Trust empowers A to support or benefit organizations other than the specified publicly supported organizations by (a) a dissolution clause that permits A to distribute its assets to organizations other than the specified publicly supported organizations upon A's termination and (b) a provision that allows A's Board of Trustees to add or remove organizations from its list of specified publicly supported organizations at will.

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

You are required to file Forms 1120, U.S. Corporation Income Tax Return, for tax periods beginning on and after December , 20 with the Service Center,

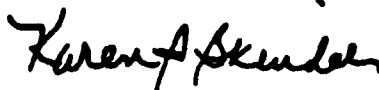
If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, a petition to the United States Tax Court, the United States Court of Claims, or the district court of the United States for the District of Columbia must be filed within 90 days from the date this determination was mailed to you. Contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217.

We will notify the appropriate State officials of this action, as required by Code section 6104(c). You should contact your state officials if you have any questions about how this determination may affect your state responsibilities and requirements.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures such as the formal appeals process. The Taxpayer Advocate is not able to reverse legally correct tax determinations, nor extend the time fixed by law that you have to file a petition in the U.S. 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. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. See the enclosed [redacted] for Taxpayer Advocate telephone numbers and addresses.

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

Sincerely,



KAREN A. SKINDER
APPEALS TEAM MANAGER

Enclosure:

1

LEGEND:

A =
B =
C =
D =
E =
F =



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY

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

May 17, 2007

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

December 31,

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear :

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

Letter 3618 (04-2002)
Catalog Number 34809F

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

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,

Marsha A. Ramirez
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer XX EIN XX		Years Ended

PRIMARY ISSUE: Whether the XX tax exempt status under Internal Revenue Code § 501(c)(3) should be retroactively revoked because it has not established that it operated exclusively for exempt purposes.

FACTS

November, 20 : The XX, with offices in XX, XX and XX, XX, engaged in tax planning for XX and XX of XX. XX issued an invoice for \$ to XX and XX for "Total Fees as per Engagement Agreement" for this tax planning. The tax planning included the establishment of the following entities, with all of the LLCs having the same two managers, XX and his wife, XX:

- XX
- XX
- XX
- XX
- XX
- XX

December, 20 : Two separate life insurance applications, completed and signed by XX and XX, husband and wife, were submitted by XX, of XX, to obtain life insurance. The December , 20 cover letter states, "XX and XX, as managers of the XX, LLC would like to apply for a \$ Stag Variable Life Policy on XX's life and a \$ Stag Variable Life policy on XX's life in order to provide cash accumulation and for estate planning purposes...The XX, LLC was established as part of their overall estate planning design and will be owner and beneficiary of the policies".

Organizing Documents

The XX Declaration of Trust (Declaration) was entered into on December , 20 . The Foundation is governed by the State . According to the Declaration, the Foundation's purpose is the establishment of an organization which is described in Section 501(c)(3) and Section 509(a)(3) of the Internal Revenue Code of 1986.

Article II, Section 1, of the Declaration provides that the Foundation will be "organized, and at all times thereafter operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of, one or more specified organizations described in Section 509(a)(1) or (2) of the Internal Revenue Code and may not engage in activities which are not in furtherance of the purposes of Section 509(a)(3)(A). The specific purpose of this Foundation is

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer XX EIN XX		Years Ended

to manage, invest, and distribute Foundation assets primarily for the benefit of the following primary supported charitable organization (The "Primary Supported Organization"):

The XX

The XX is irrevocably designated as the Primary Supported Organization and is entitled to receive such distributions as are necessary for the Foundation to qualify as a Supporting Organization to the Primary Supported Organization and may enforce its rights to such distributions to the extent necessary to effectuate the purposes of this Section. The Foundation will furnish reports at least annually to the Primary Supported Organization which will include its assets, income and expenses. The Foundation will be operated in such a way so as to be responsive to the needs of the Primary Supported Organization and may make distributions to the Primary Supported Organization through an advised fund of the Primary Supported Organization or in such other manner as is directed by the Primary Supported Organization".

The Foundation may also support thirty-eight other named 501(c)(3) charitable organizations including The XX and The XX. The primary purpose clause states "Upon majority vote of the Board of Trustees, qualified 501(c)(3) charitable organizations including the Primary Supported Organization and the other Supported Organizations which are granted the authority to select members of the Board of Trustees pursuant to Article III, Section 1 may be added to or removed from this list of organizations. The Foundation may not act to support or benefit charitable organizations other than those named pursuant to this Section", (Article II, Section 1).

Article II, Section 2 provides "No part of the Trust (including the net earnings of the trust fund) shall inure to the benefit of any private shareholder or individual and ... Notwithstanding any other provision of this Trust, this organization shall not carry on any activities not permitted to be carried on by an organization exempt from Federal income tax under section 501(c)(3) ... or the corresponding provision of any future United States Internal Revenue Law".

In Article V, Section 3, the Declaration provides "This Trust is irrevocable except as follows:

- a. Until such time as the Trustees receive a written determination from the Internal Revenue Service ... the Settlers (or their legal representatives) shall have the limited right to amend this Trust in order to obtain the said written determination; and
- b. Upon the majority consent of the Trustees and written notice to the Internal Revenue Service and the Attorney General, the Trustees may amend the Trust Agreement in any manner which does not jeopardize the qualification...under Section 501(a) of the Code and as an organization described in Section 501(c)(3) of the Code".

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer XX EIN XX		Years Ended

The Trustees' general powers and duties include, "Pursuant to this Trust Agreement and law, the Trustees shall not exercise their powers except in full compliance with federal laws governing tax exempt organizations under Section 501(c)(3) of the Code so that this Trust at all times qualifies as a tax exempt organization to which donations shall be tax deductible pursuant to Sections 170(a)(1), 2055 and 2522 of the Code".

The Declaration further provides "Assets, as used herein, shall refer to all types of property interests which may be owned from time to time by the Trustees on behalf of the Trust".

Article II, Section 3 of the Declaration describes the use of trust funds and states "The trustees in their discretion shall distribute all, or part, of the net annual income of the Trust to fulfill the purposes of this Trust. The Trustees may also invade the principal of the Trust to fulfill the purposes of the Trust".

The dissolution clause of the Declaration provides "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, assets shall be distributed for one or more exempt purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code, or the corresponding section of any future federal tax code, or shall be distributed to the federal government, or to a state or local government, for a public purpose.

Upon winding up and dissolution of this Trust, after paying or adequately providing for the debts and obligations of the Trust, the remaining assets shall be distributed to a non-profit fund, foundation, or corporation which is organized and operated exclusively for charitable, educational, religious, and/or scientific purposes and which has established its tax-exempt status under section 501(c)(3) of the Code. In the event that the Trust does not obtain tax-exempt status under Sections 501(c)(3) and 509(a)(3) of the Code, the assets of the Trust shall go to the Donor, or by power of appointment as a contingent remainder."

Regarding the board, the Declaration provides "The Board of Trustees shall initially be composed of five (5) members, a majority of which may never be disqualified persons as that term is defined by Internal Revenue Code Section 4946(a)(1). The Board shall always consist of at least three (3) Trustees. The Primary Supported Organization and The XX Foundation, Inc. (hereinafter "Voting Supported Organizations") shall, at all times, each have the right to select at least one (1) Trustee, or in the alternative an equal number of Trustees so that, at all times, the Voting Support Organizations, or their replacements, shall have the right to select a majority of the voting members of the Board of Trustees (the "Supported Trustees"). In addition, at such time, if any, as The XX is created, and provided that it is organized and qualifies as an organization described in Section 509(a)(1) or 509(a)(2) of the Code, then The

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Name of Taxpayer XX EIN XX		Years Ended

XX shall also become a Voting Supported Organization...The Family Trustees shall collectively have two votes for any matter before the Board of Trustees".

The Declaration was signed by XX and XX as Settlers and as Founders/Donors. Other signatories included XX, XX, and XX as the Trustees.

The Foundation maintains that the original trust was "inadvertently not retained" and that it was replaced by a revised trust as signed by successor trustees and the only change was the appointment of the non-family trustees. (Letter Dated December , 20 , IDR , Item)

Trustees/Board Members

Trustees per the Declaration: Three of the five original trustees listed on the Declaration, XX, XX and XX resigned in January and February of 20 and were replaced, which left XX and XX along with the following new trustees:

- XX.
- XX.
- XX.

Application for Recognition of Exemption (Form 1023)

Exemption Application Board of Directors: Per the Application, the Foundation's Board of Directors were as follows:

- XX
- XX
- XX
- XX
- XX

The XX filed Form 1023, Application for Recognition of Exemption, with the Internal Revenue Service on or around November , 20 . The Application was signed by XX.

In Part II of the application regarding disqualified persons, it stated "XX and XX are substantial contributors to the Foundation...The foundation provides that, at all times, the Foundation will be controlled by non-disqualified persons". It was further represented that the Foundation's facilities or operations will not be managed by another organization or individual under a contractual agreement and that there are no contracts or agreements.

Form 1023, Part II, Activities and Operational Information, provided "The Foundation will at all times operate to support the purposes and activities of certain named 509(A)(1) and 509(A)(2)

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
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charitable organizations. The primary supported organization of the Foundation is The XX. The Foundation will, at a minimum, distribute fifty-one (51 %) of its net income to the primary supported organization and will furnish the primary supported organization with regular financial reports. In addition to supporting the primary supported organization, the Foundation will also support certain other specifically listed charitable organizations as outlined in the trust agreement. At the direction of the primary supported organization and the other supported organizations, the Foundation will financially support a variety of activities."

Later and in response to an Information Document Request (IDR) that requested additional information on the 51 % net income distributions, a representative stated "The attorney who prepared the Form 1023 made a mistake on said form, Part II, question 1 because a Type I Support Organization is not required to make a minimum of 51 % of its net income to the primary supported organization. The Trust Agreement does not state that the Foundation will, at a minimum, distribute fifty-one percent (51 %) of its net income to the primary supported organization. Also note that the primary supported organization is provided with the financial reports that are included in the tax returns."

In response to an IDR requesting a description of the entities represented by the board members, specifically, "a description of the entities eleemosynary purpose and modus operandi", the representative responded: "The supported organizations, The XX, XX, and XX, were selected because they work with other similar supporting organizations. Each organization seeks to advance charitable giving in the private sector, especially among higher net worth donors. For example, the XX and XX specifically seek to educate individuals and families to the financial, social and personal benefits of charitable giving. The XX is committed to helping individuals, corporations and communities express themselves in the charitable, educational, scientific and religious sector and initiating charitable activities that in the spirit of charitable entrepreneurship may eventually become self-supporting independent foundations some day."

Based upon its representations, the XX was recognized as exempt from tax under section 501(a) as an organization described in section 501(c)(3) on January 1, 2000. It was classified as a supporting organization described in section 509(a)(3). Later, in a letter dated February 1, 2001, the Foundation advised the Service that the XX's name had been changed to The XX, effective December 31, 2000.

Although various LLCs were created and funded before the application for exemption was filed, there was no disclosure on the application regarding the related LLCs and the various assets held by them. Further, no LLC operating agreements accompanied the application.

State of California Exemption Application

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer XX EIN XX		Years Ended

The Foundation filed an Exemption Application, Form 3500, with the stating "The specific purpose for which the support organization was formed is to manage, invest, and distribute Foundation assets primarily for the benefit of The XX". The state granted exemption in a letter dated April , 20 . In 20 , the Foundation registered with the California Registry of Charitable Trusts.

Initial Contribution

The acknowledgement letter to XX and XX letterhead stated "Thank you for your generous contribution to the XX of \$ on December , 20 . Please retain this letter for your tax records. You did not receive any goods or services in consideration of your contributions. The XX".

Bank account transactions for the initial contribution of \$ by XX and XX show the transfer occurred in December 20 . The bank records show the following:

- **Bank Checking Accounts:** Initial business checking accounts for the Foundation and various LLCs with XX Bank also known as (aka) XX Bank were opened on December , 20 . Signature cards show XX and XX had sole signature authority.
- **XX Bank Account:** On December , 20 , a \$ check, the initial deposit, was deposited into the Foundation's XX Bank Account # XX from the personal account of XX and XX. On the same date, \$ was withdrawn from the Foundation's account leaving a \$ balance. No other activity occurred in the Foundation's bank account for years 20 and 20 . Beginning in year 20 , monthly checks in the amount of \$ signed by XX were paid to XX purportedly for investing and consulting services.
- **XX, LLC Bank Accounts:** On the same date as the \$ deposit into the Foundation's account, December , 20 , \$ was withdrawn and transferred into bank account #XX0. This account was in the name of XX, LLC. XX, LLC was owned 100% by XX and XX. This was the initial deposit into the account. This account was one of two accounts in the name of XX. The other account is #XX. The \$ deposit ticket identified account #XX as being in the name of XX, LLC. On the same date, \$ was transferred out of account # leaving a remaining balance of \$ at year end. Although XX and XX maintain account #XX was XX, LLC's bank account, XX Bank's monthly summary account statements show account #XX was owned by XX, LLC until at least October 20 . At the end of 20 , account #XX had a balance of \$ and account #XX had a balance of \$ and both were identified as owned by XX, LLC on the bank statements. In October 20 , the bank summary statements listed account # XX under XX LLC's name but still summarized it under XX LLC. Beginning in August 20 ,

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Name of Taxpayer XX EIN XX		Years Ended

account #XX was separately identified as owned by XX, LLC on the monthly bank statements.

- XX, LLC: On the same date of the initial deposit, December , 20 , \$ of the \$ that had been transferred to XX, LLC's bank account was transferred to XX Bank account #XX which was owned by XX, LLC. This was the initial deposit into this account. On December , 20 , a \$ check was written to XX from this account. The check's remarks section stated, "from XX LLC Policy #XX, Insured. The check cleared on January , 20 , leaving a \$ balance in the account.
- \$100 Contributions: Exhibits A to the LLC Operating Agreements provided for a \$ initial contribution. In Exhibit A to the XX, LLC Operating Agreement, it stated there was a \$ initial contribution by its member, The XX Foundation.

To summarize, in addition to the Foundation, two LLCs were created by XX and XX. XX and XX were the sole managers of the LLCs. The Foundation represented the entities were related as follows :

- 1) XX
- 2) XX
- 3) XX

In response to an IDR, the Foundation provided "Attached are the bank statements for XX, LLC and XX, LLC showing where the \$ went from the XX account on December , 20 . \$ was transferred to the XX, LLC bank account number XX. \$ was transferred to the XX, LLC bank account number XXX. Please note that XX owns % of XX, LLC. Also note that XX, LLC owns % of XX, LLC. Please see the attached Operating Agreements for both XX, LLC and XX, LLC."

Other entities created and controlled by XX and XX as managers, in year 20 or subsequent to year 20 , include but are not limited to the following:

- XX
- XX
- XX
- XX
- XX
- XX

Most of the bank accounts for the various LLCs were located at the same financial institutions. In 20 , the XX accounts were closed and similar accounts were opened with XX. Various financial transactions flowed back and forth between the various entities created, managed and/or owned by XX and XX including XX, LLC and XX, LLC, the two entities represented as being owned by the Foundation:

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer XX EIN XX		Years Ended

	<u>NAME</u>	<u>EIN</u>	<u>XBANK #</u>	<u>X #</u>
X		X	X	X
X		X	X	X
X		X	X	X
X		X	X	N/A
Y		X	X	X
XX		X	X	N/A
X		X	X	X
X		X	X	X
X				
X		X	Unknown	Unknown
X		X	Unknown	Unknown
X		X	Unknown	Unknown

*XX and XX (CRT) entered into a partnership agreement in February 2003 whereby the partnership profits and losses were allocated 99% to the CRT and 1% to the Foundation.

The source of funds for all the initial deposits to open the XX accounts in 2004 was from the personal bank account of XX and XX.

Board Minutes – The XX

The XX board minutes were dated as follows and stated "all of the Trustees of the Foundation were either physically present at the meeting or participated by teleconference":

- November , 20
- November , 20
- November , 20

November , 20 – XX Minutes: The November , 20 minutes read "this was the first Annual Meeting that there were no previous minutes":

- "XX was appointed Chairman of the Meeting and XX was appointed the Secretary of the Meeting".
- "the Supported Trustees shall collectively have three votes for any matter before the Board of Trustees, which shall be divided equally among the Supported Trustees that are in attendance at the meeting and that the Family Trustees shall collectively have two votes for any matter, which shall be divided equally among the Family Trustees that are at the meeting".
- Investments were reviewed to ensure that the investments are reasonable and prudent investments, and do not, either directly or indirectly, privately benefit any individual, and "that such investments are not more than an insubstantial part of the charitable activities of the Foundation" and that the Family Trustees, "provided no input regarding the

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer XX EIN XX		Years Ended

reasonableness or appropriateness of such investments and abstained from any and all votes related to such investments".

- Assets, contracts, loans, leases and/or other arrangements entered into by the Foundation were reviewed to ensure favorable terms and did not benefit, directly or indirectly, any private individuals.
- "The Board determined that any provisions regarding a minimum distribution of % of net income to the Primary Supported Organization *be removed*. This will allow the foundation to provide support in the manner it sees necessary to assist any of the listed Supported Organizations".
- The Foundation would support only those Supported Organizations of the Foundation and in addition a grant in the amount of \$ would be provided to each of the supported organizations: XX, XX, Inc. and XX.

February , 20 - XX Resolution: In a Unanimous Consent Resolution dated February , 20 , the Trustees "authorized to pay for the costs associated with establishing a Charitable Remainder Trust whereby the Foundation is named sole beneficiary with a minimum % irrevocable designation of such. The Foundation is anticipating the costs to be approximately \$ and the benefit to be derived from the Charitable Remainder Trust is anticipated to be \$... The Trustees of the Foundation hereby empowered XX and XX to sign all documents and take all other actions ... to effect the establishment of the Charitable Remainder Trust."

November , 20 - XX Minutes In the November 20 minutes the Chairman explained "the Foundation % wholly owns XX, LLC. This entity is currently being managed by XX and XX. In addition, XX currently acts as a Chairman providing consulting services for the Foundation" ... and the Investments, LLC. The Family Trustees abstained from voting and the board determined "that \$ /year still constitutes a reasonable salary."¹

- XX's qualifications are as follows:
 - MBA from XX
 - Member of XX
 - 20 Participant in The XX
 - Member of Silicon XX
 - Partner in XX

¹ XX received \$ per month. XX drew checks in the amount of \$ per month from the Foundation's bank account payable to XX as the Foundation Director. In addition, checks in the amount of \$ per month were drawn on XX LLC's bank account to XX and were noted as being a money management fee.

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer XX EIN XX		Years Ended

The board again resolved that \$ be provided to each of the supported organizations: XX, XX Foundation, Inc. and XX Foundation. An additional amount totaling \$ would be provided to various other entities exempt under IRC 501(c)(3).

November, 20 - XX Minutes: The November, 20 board minutes stated XX is elected to serve as President and XX as Vice President, Secretary and Treasurer.

- Reasonable consulting fees in the amount of \$ /month were paid to XX for remuneration for his services reviewing the Foundation's various investments, managing XX, LLC, and reviewing donations and the necessities of the Foundation. XX of XX explained "this has previously been discussed with the attorney, and the answer is, yes, so he will ask the attorney to write a Memorandum addressed to the Board of Trustees confirming that a Trustee can be paid reasonable compensation for services rendered".
- Chairman XX "explained that the Foundation currently owns a \$ XX Life Insurance policy on XX Life with a current Account Value of \$."
- "XX and XX are the current Managers for this entity and with the Board of Trustee's approval, they can go ahead and make the investment decisions and report back to the Board".

The current assets as summarized in Exhibit A to the board minutes were as follows:

<u>Current Assets</u>	
X	Owens \$ Life Insurance Policy on X's Life-Account Value at 09/30/04
X	Software company funded by X. \$ Investment
X	Venture capital leverage returns. \$ Investment
X	Fidelity mutual fund account as of 10/ /20
X	% ownership in X funds.
X	Promissory Note for \$ %
X	As of 10/ /20

The "Foundation's purpose...is to continue to grow in size so that it may continue providing support to its Supported Organizations...the Chairman stated that the Foundation's four key areas to support as follows: Job Training, Youth Development, Environmental and Human Rights."

The board again resolved that \$ be provided to each of the supported organizations: XX, XX, Inc. and XX. Grants made at the time of the board meeting totaled \$. An additional

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer XX EIN XX		Years Ended

amount totaling \$ would be provided to various other entities exempt under IRC 501(c)(3).

Board Minutes – XX, LLC & XX, LLC

Board minutes of XX, LLC were provided and reflect XX owned % of it and that it had investments in XX, LLC. The XX, LLC board minutes were dated:

- December , 20
- December , 20
- December , 20
- December , 20

All minutes were signed by XX and XX and stated the only individuals present were the two managers, namely:

- XX and
- XX

All minutes basically stated the following: "The annual meeting of the Member of XX, LLC (the "Company") was held on (day of week followed by the actual date i.e. Friday, December , 20). XX, as Trustee of The XX, which is the Member of the Company, acted as Chairman of the meeting and called the meeting to order. Roll call of the Member was read and the Member present at the meeting, which constituted a quorum, was as follows:

MEMBER

The XX
XX, Trustee
XX, Trustee

December , 20 board minutes stated the annual XX, LLC company meeting was held on December , 20 and the "Chairman read and confirmed the previous minutes of the last member meeting". The Service requested the year 20 board minutes because none had been provided. The Foundation responded that the minutes referenced the XX, LLC Operating Agreement. This implies the operating agreement substituted for the 20 board minutes.

No board minutes were provided for XX, LLC.

State of Filing for Limited Liability Company (LLC) – XX, LLC

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer XX EIN XX		Years Ended

Operating Agreement: The XX, LLC Operating Agreement dated December , 20 , states The XX has a % interest. XX is Trustee and manager and XX is the other manager. Exhibit A of the Operating Agreement reflects The XX as "Members" and the initial "Contributions" of \$

Articles of Organization: XX filed Limited Liability Company Articles of Organization for XX, LLC dated December , 20 , stating there was more than one manager. XX, LLC used a California agent for service of process:

XX
 XX
 XX

The LLC filed a bi-annual Form LLC-12 with the Secretary of State dated February , 20 . The two managers listed were XX and XX. On September , 20 , the LLC filed its second bi-annual Form LLC-12R (Renewal) which was signed by XX. The \$ annual limited liability tax was paid from the LLC bank account to the Franchise Tax Board.

Form 8832, Entity Classification Election: The Foundation stated, "Form 8832 was not required as the LLC was treated as a disregarded entity" and XX, LLC does not file a tax return because the Foundation is the sole member.

State of Alaska Filing for Limited Liability Company (LLC) – XX

EIN: The Employer Identification Number (EIN) form for XX, LLC was filed on XX.

Operating Agreement: The XX, LLC Operating Agreement was dated 12/ /20 and was signed by XX and XX, Managers. The body of the operating agreement states the following:

- "Distribution of its assets shall be conducted exclusively by the Managers who are hereby authorized to do any and all acts and things reasonably necessary to accomplish the foregoing.
- All distributions in liquidations shall be made pro rata to the Members in kind.
- The Managers shall have the right to obtain, on behalf of and at the expense of the Company, a life insurance policy or policies on the life or lives of one or more Members or any other persons which the Managers deem necessary or desirable respecting the operations of the company. The Company shall be the owner of each such policy. For each policy, if any: The named beneficiary under the policy may not be changed without the mutual consent of the Managers".
- Exhibit A states the Initial Contribution is \$ and XX, LLC is the % Member.
- Exhibit B, Designation of Beneficiary, is blank (IDR 09, Item 2).

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer XX EIN XX		Years Ended

- In response to IDR 031, Item 3, requesting partnership agreements and other documents that show XX, LLC relationships with all partners, owners, and investors for years 20 , 20 , 20 , 20 and 20 , the response was "Attached is a copy of the XX, LLC Operating Agreement showing the Member as XX, LLC. The Operating Agreement is dated 12/ /20 and there have been no changes to it since that time".

Articles of Organization: The Certificate of Organization, Limited Liability Company, was filed with the State of Alaska on XX. The accompanying form listed the LLC's managers as XX and XX and was signed and dated XX and date stamped by the State of Alaska as received on XX.

State of LLC Biennial Reports: Copies of the State of LLC Biennial Reports filed with the State of Alaska were obtained from the Foundation and from the State of Alaska. The reports identify the LLC members or managers and persons owning 5% or more interest in the LLC.

State of reports, signed by XX and filed with the State of , reported that through year 20 , XX, a personal trust, and not XX, LLC was owner of XX, LLC. Beginning in 20 , the State of reports reflected that XX, LLC was owned by XX, LLC.

Form 8832, Entity Classification Election: In response to a request for entity classification, the Foundation's representative stated "Form 8832 was not required as the LLC was treated as a disregarded entity." (IDR 31, Item 2)

Form 990, Return of Organization Exempt From Income Tax

Each year XX signed the annual Form 990 returns filed with the Service. The 20 and 20 Form 990 annual returns stated the books were in care of XX) in XX, . The returns were prepared by XX, LLP in , . Schedule A attached to Forms 990 for 20 and 20 , stated the Foundation's "primary exempt purpose is to manage, invest, and distribute Foundation assets primarily for the benefit of The XX, which is the primary supported charitable organization. The Foundation may also support the 501(c)(3) organizations listed on Form 990, Schedule A, Page 2, Part IV, Line 13." Forms 990 for the years ending December , 20 through 20 reported the following revenue and expenses and assets with no liabilities except for \$ in year 20 :

FORM 990 REVENUE _____

- Contributions
- Interest on Savings
- Dividends & Interest
- Other Revenue

Plus:

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer XX EIN XX		Years Ended

Gross Amount- Sale (Sec)	0				
Less Cost/Expense	0				
Gain (Loss) (Securities)	0				
Net Income					

FORM 990 EXPENSES

Program Services	0				
Management & General	0				
Other Expenses	0	0	0	0	0
Total Expenses	0				

Excess (Deficit) for Year	6,000,000	-7,023	-442,025	-128,207	10,236
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Net Assets BOY	0				
Increase in Net Assets					
Other Changes in Net Assets	0	0			
Net Assets/Fund Bal EOY					

ASSETS

Cash					0
Savings					
Investments					
Other Assets					
Assets EOY					

LIABILITIES

Other Liabilities	0	0	0	0	
Liabilities EOY	0	0	0	0	

NET ASSETS

Although the Foundation claimed XX, LLC was treated as a disregarded entity, the liability of \$ on the balance sheet for 20 was reported as due to XX, LLC on Statement 9 attached to the return.

On attachments to the annual information returns, the Foundation reported the following assets/investments:

FORM 990 INVESTMENTS

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer XX EIN XX		Years Ended

X	0	0			
X	0	0			0
X	0	0			
X	0	0	0	0	0
X	0	0			
X	0	0			
XX	0	0			
X	0	0			
X	0	0	0	0	
<i>Subtotal</i>		0			
Due fm X, LLC		0	0	0	0
Cash & Temporary Investments			0		
<i>Total</i>					

XX Life Insurance: Beginning in 20 , an investment of \$ in XX Life Insurance was reported on the Forms 990. The amount represented the December 20 and 20 premiums totaling \$ for the purchase of the \$ life insurance policy on XX by XX, LLC.

XX Loan: Beginning in 20 , the Foundation reported a \$ loan to XX as an investment and not as a receivable on the balance sheet. No loan information was disclosed on Schedule A including any collateral received by the SO for the loan.

XX Investment - \$: In the initial interview, XX stated that a \$ investment was made in a private company called XX a startup tech company. The money was invested as seed capital. Mr. XX stated that XX, a venture capital company, also invested in XX.

Legacy Ventures - \$: The Foundation provided the 2003 Schedule K-1 to Form 1065 for Partner #8, XX, LLC XX, LLC. The year-end capital account of \$ for XX, LLC represented a % interest in XX II, LLC. During the initial interview, XX stated the partnership is a "fund of funds for venture capital investments." The minimum investment is \$1 Million and, as of 20 , the Foundation has committed \$ of the \$. XX stated he met with other partners on a regular basis. So far, the fund has had a break-even status.

Other Assets/Investments: All of the assets and/or investments were held in the names of various LLCs and only a minimal amount of cash was directly held in the name of XX or The XX. Statement 8 attached to the Form 990 for 2004 stated that \$ was due from XXI, LLC.

XX Investments Account Application: The XX Investments account application identified XX, LLC as account holder but did not identify the LLC as being wholly owned by the Foundation. The individual signors, XX and XX, were not identified as trustees of the Foundation.

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer XX EIN XX		Years Ended

Form 990 Distributions for Charitable Purposes

For years 2000 through 2004, grants of \$, \$, \$ and \$ respectively to various IRC 501(c)(3) organizations, including an annual amount of \$ to \$ to the XX, were reported on the Forms 990. All of the grants for 2003 and some of the grants for 20 were paid by check from the XX, LLC bank account. There was a \$ discrepancy between the amount of the grants per the bank records (\$) and the amount reported on the Form 990 for 2003 (\$). There was a \$ discrepancy between the amount of the grants per the bank records (\$) and the amount reported on the Form 990 for 2004 (\$). The following is the information reported on the Forms 990 with the discrepancies for 20 and 20 noted in **Bold** print:

	<u>IRC 501(c)(3)</u>	<u>20</u>	<u>20</u>	<u>20</u>	<u>20</u>
X		0		0	
X		0	0	0	
X		0	0	0	
X			0	0	0
X			0	0	0
X			0	0	
X		0		0	0
X		0		0	0
X		0		0	0
X		0		0	
X		0		0	
X		0		0	
X		0		0	
X		0		0	
X		0		0	
X		0		0	
X		0		0	
X		0		0	
X		0		0	
X		0	0	0	0
X		0	0	0	

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer XX		Years Ended
EIN XX		

X	0	0		
X	0	0		0
X	0	0		
X	0	0		
X	0	0		
X	0	0		
X	0	0		
X	0	0		
X	0	0		
X	0	0	0	
X	0	0	0	
X				0
X				0
TOTALS				

Contributions Per Form 990 Return

Form 990 Expenditures

For years 20 through 20 , the XX reported expenses as follows:

<u>EXPENSES</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Other losses – Investments	0	0	0	0	
Taxes	0			0	
Foreign Taxes Paid	0				
Licenses & Fees	0				
Interest					
Investment Fees	0			0	
Inv Fees – Passthru Entity	0	0	0		0
Consulting Fees	0	0			
Total Expenses	0				

\$ was paid annually to XX for years 20 through 20 as investing and consulting fees. Despite a request that they be produced, no documents were provided that identified recipients of the remaining 20 investment fees of \$ from pass-through entities and 2004 investment fees of \$. For years 20 and 20 , XXX compensation (consulting

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer XX EIN XX		Years Ended

fees) represented % and % respectively of total expenses paid by the Foundation including amounts for charitable purposes:

<u>FORM 990 EXPENSES</u>	
Program Services	0
Management & General	0
Other Expenses	0
Total Expenses	0

**Form 990 Disclosures Regarding Related Party Transactions
(Exempt and/or Taxable Subsidiaries, Disregarded Entities, and Partnerships)**

On Forms 990 for years 20 and 20, Part VI, Other Information, the Foundation answered "no" to question 80a: Is the organization related to (other than by association with a statewide or nationwide organization) through common membership, governing bodies, trustees, officers, etc., to any other exempt or nonexempt organization. However, in Part IX of the return, "Information Regarding Taxable Subsidiaries and Disregarded Entities", the Foundation noted, "See Stmt __", a statement that reported the Foundation's % ownership in XX, LLC.

On Forms 990 for 20, 20, and 20, Part VI, Other Information, the Foundation answered "yes" to question 80a: Is the organization related to (other than by association with a statewide or nationwide organization) through common membership, governing bodies, trustees, officers, etc., to any other exempt or nonexempt organization and checked the exempt box noting, "See Statement ...", which disclosed a relationship with the following public charities:

- XX
- XX
- XX

Year 20 Form 990: In Part III, Question 2b of Schedule A attached to the Form 990 for 2001, the Foundation answered yes to the "Lending of money or other extension of credit" and noted, "See Stmt 8". Statement 8 provided:

- "XX, LLC, which is wholly owned by the XX, loaned \$ to XX, LLC. XX, LLC is managed by XX and XX who are trustees of the XX. However, XX and XX are not members of XX, LLC.
- XX, LLC also loaned \$ to XX, LLC. XX and XX each own % of XX, LLC.
- XX, LLC also loaned \$ to XX, LLC. XX and XX each own % of XX, LLC."

Year 20 Form 990: In Statement 7 to Form 990, Part IV, Line 56, Other Investments, the Foundation reported \$ as an investment in XX, LLC.

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer XX EIN XX		Years Ended

Year 20 Form 990: On Line 88 of Part VI, Form 990 Other Information for 20 , the Foundation reported it owned a % or greater interest in a taxable corporation or partnership, or an entity disregarded as separate from the organization under Regulations sections 301.7701-2 and 301.7701-3. On Statement 9, the Foundation reported a % ownership in XX, LLC with end-of year (EOY) assets of \$. The Foundation reported total assets of \$ and income of \$. Thus, \$ was its investment in XX, LLC and its only other asset was \$ that was reported as non-interest bearing cash on the Form 990.

Year 20 Form 990: In Part IX of the return, "Information Regarding Taxable Subsidiaries and Disregarded Entities", Statement 12 reported the Foundation's % ownership in XX, LLC. The LLC was reported to have \$ in income and \$ in assets.

On Line 88 of Part VI, Form 990 Other Information for , the Foundation reported it owned a % or greater interest in a taxable corporation or partnership, or an entity disregarded as separate from the organization under Regulations sections 301.7701-2 and 301.7701-3. On Statement 9, the Foundation reported a % ownership in XX, LLC, with EOY assets of \$. The Foundation reported total net assets of \$ and income of \$. Thus, with the exception of \$, all of the Foundation's assets were held in the name, XX, LLC.

Statement 8 provided \$ was due to the Foundation from XX, LLC. Statement 9 reported the Foundation owed \$ to XX, LLC.

Supporting Organization Activities and Transactions

Transactions and activities conducted by the Foundation through its trustees, XX and XX were as follows:

1) \$ Loan to XX % - \$ Transfers to XX & XX

Form 990: Forms 990 for years 20 through 20 reported, "Loan to XX % - \$" as "Other Investments" in a Balance Sheet attachment. It was not reported as a receivable and there was no collateral for the loan.

Promissory Note - XX Loan: The Promissory Note, dated June , 20 , stated:

Borrower: XX, A corporation
Lender: XX, LLC, a limited liability company
Amount: \$
Maturity: June , 20

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer XX EIN XX		Years Ended

The promissory note stated the borrower will make annual interest payments of % per annum and pay all principal and interest in full on June , 20 . The note was signed by XX, V.P. of XX.

XX Corporation Guarantee

Attached to the Promissory Note was a Guaranty by XX Corporation (Guarantor). The Guaranty states that as an inducement to Lender to lend \$ to XX Corporation (Borrower) pursuant to the terms of that certain Promissory Note dated June , 20 (Promissory Note), the Guarantor agreed:

1. "Borrower shall promptly and full perform, pay and discharge all of its liabilities, obligations, and indebtedness arising from or relating to the Promissory Note...if Borrower fails to pay...Guarantor agrees to pay the Indebtedness on demand"
2. "Guaranty is an absolute and unconditional Guaranty of payment and not of collectability".
3. ..."Lender shall not be required to (i) to proceed against Borrower by suit or otherwise..."
7. ..."Guaranty shall remain in full force and effect until all Indebtedness has been fully paid".
14. ..."Each Guarantor shall be jointly and severally liable, with each other and with Borrower, for all obligations and liabilities arising under this Guaranty".
15. "Guaranty, together with the Promissory Note, constitutes the entire agreement between Lender and Guarantor concerning the subject matter hereof, and may not be altered or amended except by written agreement signed by Lender and Guarantor. All prior and contemporaneous agreements, arrangements, and understandings between the parties hereto as to the subject matter hereof are rescinded.

The Guaranty was signed by XX, Vice President of XX and was dated June , 20 . Each unsigned page of the Guaranty was initialed by "X".

XX Annual Interest on \$ Loan: A copy of XX Financial Corporation's check for the annual interest payment of \$ dated July , 20 was provided. The check was payable to XX, LLC and was reported on the Foundation's 20 annual information return, Form 990, as interest income. The check was deposited into XX, LLC account with XX. Subsequently, for 2004, interest income of \$ was reported on the Form 990 as well.

November , 20 - XX Minutes: The November , 20 minutes stated "XX and XX are the current Managers for this entity and with the Board of Trustee's approval, they can go ahead and make the investment decisions and report back to the Board...the Foundation owns a Promissory Note for \$ with a fixed interest rate of % which will be due by

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer XX EIN XX		Years Ended

June 20 and which the Foundation will look at reinvesting at that time". Current assets attached to the minutes included the amount of \$ with XX (XX).

XX Collateral and Investment Rating: Although repeatedly requested both verbally and in writing, no information and/or documentation regarding any collateral to secure the \$ promissory note was provided other than the statement, "the Promissory Note and the Guaranty, which acts as the collateral." As to questions about XXs investment rating, the response was "XX is not a public company therefore there is no rating. The majority of all correspondence was verbal...a check issued to them for \$." (IDR 023, Item 4)

XX's Unaudited Financial Statements: Note 5, Amounts Due to Related Parties, in XX's unaudited consolidated financial statements for Year 20 stated, "The amounts due to related parties are broken down in the following manner: \$ to XX Development..." and denotes that XX is a related entity.

XX Subsidiaries and/or Related Entities: XX has numerous subsidiaries and related entities including XX Ltd., XX LLC, XX, LLC, XX, LLC (XX), etc. XX and the related entities are engaged in tax shelters involving oil and gas exploration and mare leasing activities. XX and XX personally engaged in transactions with XX and/or XX related entities. For instance, on December , 20 , XX, LLC, XX, issued Check # , drawn on XX, payable to XX for \$. The XX check was endorsed by XX and was deposited into the personal XX checking account # XX of XX and XX.

United States District Court, Eastern District of -

XX Court Documents: On XX, several plaintiffs filed documents with the U.S. District Court clerk of the Eastern District of against XX, LLC, XX, LLC, XX, etc. stating, "Operating in a number of states, including , defendants aggressively marketed and sold thoroughbred mare Lease Programs (*the) to wealthy individuals interested in the thoroughbred horse industry. The United States government is currently pursuing a criminal investigation into the activities of the defendants relating to the , and in February, 20 acting on federal search warrants, seized the books and records of XX, LLC. As a result, the participation of Plaintiffs and all others who participated in the have been called into question...Defendant XX, LLC ("XX") is a limited liability company organized and existing under the laws of Utah and authorized to conduct business in ...XX and/or XX, LLC operate two horse farms ... in XX, LLC ("XX") is a limited liability company organized and existing under the laws of ...XX ("XX") is a corporation organized and existing under the laws of with a registered agent located in ...XX is a closely-held corporation that owns, indirectly though subsidiaries, XX...In addition to XX, XX owns approximately % of XX, a publicly

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer XX EIN XX		Years Ended

traded corporation...have agents, or transact their affairs...and conducted their fraudulent scheme, through use of the United States Mail or interstate wire communications in an illegal manner". The suit further cites the peddling of "XX Mare Lease Programs as an extremely profitable opportunity, with a historical net cash return on investment of %...XX Brochures also touted its ownership of high quality thoroughbred mares and its ability to provide the 'Ultimate Tax Solution, which converts ordinary income to long-term capital gains'...the Mare Lease Programs included a feature whereby the participants could defer the profit on the sale of their foals and, by exchanging their interests in the foals or leases for ownership units in one or more limited liability companies or partnerships, obtain capital gains treatment for the income from their participation in the mare Lease Program...XX...made available both stock and working interests in gas properties which it owned in order to facilitate this aspect of the program and offer further incentives to participants...".

The suit further discussed the investment as follows: as an "Illustration... for an up-front investment of approximately \$ in XX, 'a division of the XX Group,' ...participation would generate tax savings of approximately \$ and net after tax mare lease revenue of approximately \$...The Illustration also offered the option of using a percentage of the interests for repayment of the NELC loan and, by virtue of a put option associated with the XXX stock, provided for a projected net after tax return of %." 2

\$1M XX Deposits

XX Related Deposits of \$: There were two separate \$ transactions, one that occurred in October 20 and one in January 20 that originated from XX and/or XX related entities that were deposited into the XX, LLC bank account. On the very same dates as the monies were deposited from XX, the amounts were transferred by XX to personal bank accounts of XX and XX:

- On October , 20 , a \$ deposit was made by XX to XXX, LLC, XX Acct. #XX. On the same date, the \$ amount was withdrawn from the XX, LLC bank account by XX. The explanation provided was that it was a deposit error: "The \$ was paid to XX and XX as per the terms of a Stock Purchase Agreement dated March , 20 , between them personally and XX, LLC. A \$ payment was due September , 20 , but not paid until October , 20 . Incorrect wiring instructions (account number) were accidentally provided to XX and thus the \$ due to XX was mistakenly placed into the XX".

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer XX EIN XX		Years Ended

- On January , 20 , another \$ wire transfer deposit was made by a XX related entity (XX) to the XX, LLC XX Acct. #XX.³ On the same date, January , 20 , the \$ was withdrawn from Account # XX by XX and deposited into the personal XX bank account #XX of XX and XX.

IDR 032, Item 2

IDR 032, Item 2, addressed the issue of the \$ deposits that were stated as being incorrectly deposited into the XX, LLC bank account.

In response to IDR 032, the following documents were provided:

- On the same bank statement from the personal account of XX and XX⁴ as the \$ check dated December , 20 , to the Foundation,⁵ there was another \$ check dated December , 20 , and payable to XX, Inc. for an investment in XX gas. For years 20 and 20 , XX and XX individually received \$ and \$ for investment returns of \$ % and % respectively.⁶

DATE	BANK	ACCOUNT	AMOUNT	NAME
XX		x		Unknown
x		x		x
x		x		x
x		x		x
x		x		x
x		x		x
x		x		x
x		x		x
x		x		x
xx				
xx				

³ Summoned January 20 bank statement received from third party record keeper, X(West),

⁴ X

⁵ As previously noted, \$ of this amount was immediately withdrawn from the Foundation's bank account and was deposited into the account of XX, IncXX and XX own % XX, Inc.

⁶ This was not the experience of a related investor. For years 20 and 20 , the two years XX, LLC filed Form 1065 returns, it reported losses related to its investments in XX and mare leasing. XX, LLC is wholly owned by XX and XX who are its sole members. Subsequently the investment and financial transactions of XX, LLC were reported on XX and XX personal returns.

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Name of Taxpayer XX EIN XX		Years Ended

XX and XX invested \$ _____ initially. This investment changed form as follows:

<u>DATE</u>	<u>FROM</u>	<u>TO</u>	<u>AMOUNT</u>	<u>PURPOSE</u>
X		X	\$	
X		X	\$	
X		X	\$	

Bank records reflected the following deposits into the accounts as noted below:

<u>Date</u>	<u>Actual Date</u>	<u>Desc.</u>	<u>Amount</u>	<u>Bank Acct.</u>	<u>Bank</u>	<u>Acct. #</u>	<u>Source Wire Xfer</u>
		Principal		X	X	X	?
		Principal		X	X	X	?
		Principal		X	X	X	X
		Principal		X	X	X	X
		Principal		X	X	X	X
		Principal		X	X	X	X
		Interest		X	X	X	X
	<u>Total</u>						

The two \$ _____ deposit amounts were deposited into the XX, LLC bank account in October 20 _____ and in January 20 _____ and then withdrawn and deposited into XX and XX personal bank account. XX and XX contend the amounts belong to them personally.

During April 20 _____, information provided to another IRS agent regarding the personal investments of XX and XX with XX related entities included the following statements:

"1. The XX were leasing broodmares, which they bred to produce foals. Under terms of the leasing and breeding agreement, the foals produced from the breeding activity are owned by the XX and the leased broodmares are returned to the lessor...The XX sold their interest in their unborn 20 _____ foal in August 20 _____. It was sold (exchanged) for a working interest in the XX Program."

"3. ...Please note that on December _____, 20 _____ the XX's owed \$ _____ on the XX _____, which included \$ _____ of accrued interest. The original amount borrowed on this loan was \$ _____. Also note that on December _____, 20 _____ the XX's owed \$ _____ on the XX _____, which included \$ _____ of accrued interest. The original amount borrowed on this loan was \$ _____. The total amounts owing on the _____ (\$ _____) and the _____ (\$ _____) equal the amount borrowed (\$ _____) on the XX, LLC income tax return."⁷

⁷ XX, LLC. Also, see

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer XX EIN XX		Years Ended

"...The balance sheets for the XX, LLC tax returns are incorrect because the Assignment of the Lease and Breeding Agreement (Lease) did not include any liability...XX XX, husband and wife, wholly own XX, LLC as community property...may treat the entity as a disregarded entity for federal tax purposes. "

"6. ...The XX contracted with XX to feed and care for the leased broodmares. In 20 , XX did not have a farm of its own. It contracted with other farms in the Lexington Kentucky area to board the horses."

IDR 037, Item 2

In response to IDR 037, Item 2, the following additional support documents were provided:

- Excluding the two \$ transactions, the bank account transactions, before and the bank account transactions after, were directly deposited into the personal bank account of XX. The final \$ payment included interest of \$ for a total deposit of \$. Only the two \$ amounts were deposited into the XX, LLC bank account – and one of these differed in origin (XX versus XX).
- On 10/15/2004, \$ wire transfer to XX, LLC reflected the originator was "XX".
- 01/06/2005, \$ wire transfer to XX, LLC reflected the originator was "XX".

The following documents were provided:

United States District Court, Northern District of -

- In a letter dated July , 20 , XX and XX, Managers of XX, LLC, requested XX Financial Corporation to contact the two managers, "in regards to how you plan to satisfy payment in full of the \$ principal and accumulated interest at % since June , 20 ".
- In a letter dated August , 20 , the law firm of XX was retained for an initial amount of \$ with respect to the claims of XX, LLC against XX Financial Corporation ("XX"). The retainer letter provided to the Service was missing Pages 3 and 4. The missing pages to the retainer letter were subsequently provided (IDR 037) and included the statement, "By signing this letter you acknowledge that our firm also represents and will in the future represent other clients with claims against XX and/or it affiliates and principals . . . and forever waive any conflict of interest arising in the firm's joint representation of you and others with claims against XX, its affiliated companies and/or its principals".

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer XX EIN XX		Years Ended

- In XX, XX, LLC filed civil proceedings against XX with the United States District Court, Northern District of _____ for breach of contract in failing to pay a promissory note when due. The body of the document stated the amounts included the principal sum of \$ _____ .00 plus accrued interest in the sum of \$ _____ or such other and greater sums as may be proven at trial.
- On XX, XX answered the complaint: "Defendant alleges they are not liable to FLI because any alleged Note has been paid in full, and FLI is due no more monies."⁸
- On XX, a case management conference was held in the US District Court, _____ District at _____ with Judge XX. Counsel for the Plaintiff stated to the Judge that it was a straightforward case for the \$ _____ in loan principal plus interest. Counsel for XX stated that his client telephoned right before the conference and stated the case involved a series of transactions including leasing, investments, and mining. And the amount due to the Plaintiff was at least \$ _____ less than the claimed amount. The Judge responded by mandating an accounting by January _____, 20 _____. The claim is to be presented before a magistrate judge in February or March 20 _____ with potential deferral back to the U.S. District Court on April _____, 20 _____.
- XX court documents dated January _____, 20 _____ included:
 - At the present time, XX does not dispute that the principal is due on the subject note. This is based on our review of the documents we currently possess, and may change as new documents and evidence are discovered. Further, this does not take into account any setoffs.
 - XXs current investigation evidences that a significant setoff overpayment in excess of \$ _____ has been paid, which should be deducted from the amount owed. We are currently assessing whether other overpayments were made.
 - The Internal Revenue Service is currently in possession of computerized records, documents, and other relevant XX documentation relative to the overpayment. This has made it difficult to obtain all possible supporting documents. Moreover, your failure to adequately respond to discovery has made resolution of this matter more difficult. XX will address discovery issues in a forthcoming meet and confer letter.
 - Documents produced in our initial disclosure are also relevant to this accounting. We will not produce them again.
- On March _____, 20 _____, Declaration of XX was filed with the U.S. District Court as one of the five Trustees of the XX stating that no payment, other than the three interest payments had been received by _____. XX declarations included these statements:

⁸ refers to XX, LLC.

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer XX EIN XX		Years Ended

Statement 16: "Defendant then includes in Exhibit B a copy of the Note, as well as a guarantee of payment provided by XX Corporation, an entity that is not a party to this action".

Statement 18: "Defendant produced documents relating to transactions involving The XX and other entities. None of the parties involved in those transactions were either FLI or the Defendant",

Statement 19: "In addition to being a Trustee of XX, I am also a Trustee of the XX. In that capacity I can and do testify that The XX is a Trust organized and existing under law, with me and XX as its two Trustees."

Statement 20: "The assets of The XX are managed entirely separately from, and have no relationship to, the assets of either XX or ."

Statement 21: "The Note which is the subject of this action has no relationship to the XX".

- U.S. District Court summary judgment is scheduled for May , 20 .

To summarize:

- In 20 , XX and XX invested \$ with a XX related entity and during the same period, and from the same bank account, the XX bank account was funded with another \$. (But see footnote 6 above)
- In 20 , XX and XX, as trustees, facilitated an unsecured loan between the Foundation, via XX, LLC, and XX with approximately % or \$ of the Foundation's assets. No collateral was received by the Foundation in exchange for the \$ except for the XX Corporation Guaranty.
- XX and XX personally and through another LLC had investments with XX and/or XX related entities involving mare and coalbed methane gas leasing as reported on their personal returns and on returns of XX, LLC, an LLC wholly owned by them. It was represented to another IRS agent that these investments were acquired with loans: A XX of \$ (original amount) and a XX of \$ (original amount). As of December , 20 , XX and XX owed \$ on the XX and owed \$ on the XX for a total amount of \$ (including interest).
- In October 20 and again in January 20 deposits of \$ were wired into the XX, LLC account by XX and XX respectively. On the same dates, XX and XX withdrew each of the two \$ amounts and transferred them to their personal bank accounts at the same financial institution.
- XX and XX maintain the \$ transfers are returns of their principal.
- In August 20 , XX and XX retained counsel and filed a claim on behalf of XX, LLC against XX Corporation, Case # XX for the \$ loaned to XX but unpaid at maturity plus outstanding interest.

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- In December 20 , XX declared before a U.S. District Court judge that the \$ amount due XX, LLC was at least \$ less than claimed and that the case involved a series of transactions including horse leasing, investments, and mining.
- Dated January , 20 , XX court documents stated that a significant setoff overpayment in excess of \$ has been paid and there may be additional overpayments. However, obtaining additional documents may be difficult because an IRS division is currently in possession of XX documentation.
- Dated March , 20 , XX filed a declaration that included statements that the Guarantor, XX Corporation, is not a party to the action, the XX and other entities are not party to the transactions involving or the defendant, and the assets of the XX are managed entirely separately from, and have no relationship to the assets of either XX or

2) XX, LLC Transactions

In addition to the initial deposit of \$ in year 20 , to the XX, LLC XX, the LLC had the following transactions:

- On December , 20 , there was a transfer of \$ from the XX, LLC's XX Account to XX, LLC XX. The amount was then telephone transferred to XX, LLC's bank account and was withdrawn for a "cashier's check" payable to in the amount of \$. The Foundation's representative stated a cashier's check rather than a regular check had been issued because XX and XX were on travel status.
- In January 20 , a \$ check was issued for payment of the XX, LLC filing fee.
- On January , 20 , \$ was transferred from the personal account of XX and XX to the XX, LLC XX Bank Account. On February , 20 , a check was issued from the XX, LLC account payable to the XX for an "annual fee". Invoice , dated 01/ /20 stated the \$ payment was for the annual fee for the XX Irrevocable Trust, c/o XX, PO Box , XX. The XX Irrevocable Trust is not a Foundation entity. It is an entity created, owned and controlled by XX and XX with their son, XX, as beneficiary.
- In 20 , the XX National Bank account for XX, LLC was closed. On June , 20 , XX Account # XX was opened with a \$ deposit and another deposit of \$ on June , 20 . The source of the funds for the \$ deposit was from XX and XX personal account.

XX Deposit Account Application: The business entity selected on the 2004 XX Deposit Account Application for XX LLC was that of an unincorporated association and business trust. Options available but *not selected* on the account application were "Not For Profit" and "Public

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Entity". Private investments/charitable foundation were listed as the Industry/Business Activity. In response to a question about "to what industry does the business sell, the application stated "N/A. Private Investments Only". The signed XX Deposit Account Application stated that two managers, XX and XX, each owned % of the entity.

State of XX LLC Biennial Reports: Copies of the XX LLC Biennial Reports filed with the State of XX were obtained from the Foundation and from the State of XX. Specifically, in Box of the ⁹ for the periods ending December , 20 , 20 and 20 , the State of XX required "names and addresses of:

- 1) the LLC's members or managers; and
- 2) persons owning % or more interest in the LLC".

State of XX reports, signed by XX and filed with the State of XX, reported that through year 20 , XX Irrevocable Trust (not XX, LLC) was owner of XX, LLC. State records provided:

	<u>NAME</u>	<u>ADDRESS</u>	<u>CITY STATE ZIP</u>	<u>MBR.</u>	<u>MGR.</u>	<u>% INT.</u>	<u>% INT.</u>	<u>% INT.</u>
X		X	X		X	%	%	%
X		X	X		X	%	%	%
X		XX	X	X		%	%	
X		X	X	X				%

- Therefore, XX, not once but twice, provided information to the State of XX that the XX Irrevocable Trust was the % member and owner of XX, LLC through year 20 .
- Information provided to the State of XX contradicted information provided to the Service that XX, LLC was at all times the % member and owner.
- As such, the owner would also hold the \$ life insurance policy on XX.

In 20 , ownership of XX, LLC was changed from the XX Irrevocable Trust to the XX, LLC on the state report filed with the State of XX.

XX Irrevocable Trust – Relationship to XX, LLC

Trust Document: The XX Irrevocable Trust dated December , 20 , was signed by XX and XX as "settlers" and named as beneficiaries, the couple's son, XX, born on November , 19 , and any children subsequently born to or legally adopted by Settlers. The irrevocable trust document further states "In particular, the Investment Trustee may invest assets in XX, LLC, an XX limited liability company for the purposes expressed herein, may make capital contributions to XX, LLC and become a member of XX, LLC. . . It is Settlers' expressed desire

⁹ State of & LLC

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that this Trust will work in conjunction with XX, LLC to invest, distribute and manage its assets". The purpose of the Trust is to trade, buy, lease, improve, develop and sell real estate, personal property, minerals, oil and gas and allied enterprises...either directly or through various entities owned by the Trust¹⁰. At the age of 25 or older, each child of the settlers shall be entitled to one vote.

During the initial interview, the Foundation's representative stated The XX Irrevocable Trust did not materialize. However, in response to IDR 008, Item 4, Forms 1041 were provided for the XX Irrevocable Trust. For years 20 and 20 , the returns had a XX address and for years 20 through 20 the returns were filed in care of the XX Trust Company, XX. For years 20 through 20 , the returns reported a fiduciary fee of \$.

Trustee Fees:

- Dated January , 20 , Invoice for \$ was issued for the annual fiduciary fee for the XX Irrevocable Trust, c/o The XX (XX), PO Box , XX, XX.
- On January , 20 , \$ was transferred out of the personal account of XX and XX into the XX, LLC XX Bank Account. The source of funds was a \$ loan advance for XX and XX's personal account # with XX Bank.
- On February , 20 , a check was issued from the XX, LLC bank account payable to the for the "annual fee" for the annual fiduciary fee for the XX Irrevocable Trust.

To summarize:

- XX and XX created the XX Irrevocable Trust. The Trust's beneficiary, xx is the creators' son. The annual fiduciary fee is \$.
- The Declaration of Trust dated December , 20 , specifically provides that the Trust will work with XX LLC and be a member to XX LLC.
- XX and XX created the XX, LLC, which was represented to the Service as being wholly owned by XX, LLC. XX, LLC was further represented to the Service as being wholly owned by the XX Foundation. In 20 , XX, LLC purchased a \$ life insurance policy on the life of XX for \$. The source of the funds was the initial deposit of \$ into the Foundation's bank account. Of this \$, \$ was transferred to XX LLC's bank account and then \$ was transferred to XX LLC's bank account.
- In 20 , \$ was transferred out of XX and XX's personal bank account and was deposited into the XX LLC bank account. A \$ check was issued from the XX, LLC bank account to pay the XX Irrevocable Trust annual fiduciary fee.

¹⁰ See XX and XX subsidiaries and related entities.

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- For years 20 through 20 , XX filed State of XX documents that reported the XX, LLC was owned by the XX Irrevocable Trust, a trust created by XX and XX to benefit their son.

3) Applications, Policies, and Transactions

November , 20 - XX Foundation Minutes: The November , 20 minutes stated "The Chairman explained that the Foundation currently owns a \$ on XX's Life with a current Account Value of \$. In Exhibit A to the minutes it stated that XX, LLC is the % owner of the policy.

Although the Foundation provided some of the life insurance documents, such as a copy of the policy and application, beneficiary information and cash surrender value, a third party record keeper summons was issued to . Documents received included a copy of a December , 20 , XX (XX) cover letter that stated, "XX and XX, as managers of the XX, LLC would like to apply for a \$ on XX's life and a \$ on XX's life in order to provide cash accumulation and for estate planning purposes...XX and XX are married...The XX, LLC was established as part of their overall estate planning design and will be owner and beneficiary of the policies."

Applicant, XX: The cover letter included an application for \$ of life insurance with dated December , 20 , for applicant, XX. The beneficiary information was a "limited liability corporation for trust fund". XX signed as proposed insured and XX signed as applicant/owner. The initial premium was set at \$. The narrative attached to the application stated "The applicant is married to XX. (See Companion Report.) They have one child, XX. Child is in good health" and the applicant has no life insurance in force. The beneficiary/purpose of the insurance is cited as follows: "The Beneficiary of this life insurance application is a Limited Liability Corporation that is being developed as a Trust Fund to fund a retirement plan as well as to provide for future estate planning requirements".

IDR 031, Item 7: IDR 031, Item 7, was issued to request an explanation as to why the was selected for an investment and how it furthers the charitable activities and purpose of the Foundation. The response was "At the time XX and XX established the Foundation, the goal was to be able to donate upwards of \$ a year for a period of ten years. This goal was based on their desire to create a sizable Foundation to ensure there was a sufficient endowment to provide assistance to the named supported organizations on a perpetual basis. The premium paid on the insurance was based on the desire to immediately fund the endowment in case of XX's premature passing. In addition, the Foundation could use the policy as a resource for obtaining monies in the future due to the policy owner having access to the cash value. The original goal had been to insure both XX