



MANUAL TRANSMITTAL

Department of the Treasury
Internal Revenue Service

4.75.31

OCTOBER 18, 2019

EFFECTIVE DATE

(10-18-2019)

PURPOSE

- (1) This transmits revised IRM 4.75.31, Exempt Organizations Examination Procedures, Conversion of Returns.

MATERIAL CHANGES

- (1) This revision incorporates editorial and procedural corrections from the previous version.
- (2) The terms “examiner” or “examiners”, replaces “agent” or “agents”. The terms “examination”, “examining” or “examined” replaces “audit”, “auditing” or “audited” where appropriate, in compliance with the Plain Language Act. See www.plainlanguage.gov. Generally, official titles and designations do not reflect this change.
- (3) Revised IRM 4.75.31.1, Program Scope and Objectives, to reflect updated plain language.
- (4) Removed IRM 4.75.31.1.1, Background, to be consistent with other revised IRMs.
- (5) Revised IRM 4.75.31.1.1, Authority, to reflect newly consolidated IRM 1.2.1, Servicewide Policy Statements and IRM 1.2.2, Servicewide Delegation Orders. (TEGE-04-0819-0015, Consolidation of policy statements and delegation orders into two new IRM sections)
- (6) Revised IRM 4.75.31.3.1 (6)(e) and IRM 4.75.31.3.1 (7)(c), Converted Tax Return Secured - To Be Further Adjusted to reference new procedures for deleting AIMS accounts in IRM 4.75.16.3.1, Deleting AIMS Accounts. (Interim Guidance TEGE-04-0618-0016, Form 10904, Deletion Requests.)
- (7) Revised IRM 4.75.31.3.3, The FAST to reflect correct mailing address for the FAST. (Interim Guidance TEGE-04-0517-0019, Procedures Following the TE/GE Reorganization)
- (8) Revised IRM 4.75.31.4 (6)(h) and IRM 4.75.31.4 (9)(c), Substitute for Return - Converted Tax Returns to reference new procedures for deleting AIMS accounts in IRM 4.75.16.3.1, Deleting AIMS Accounts. (Interim Guidance TEGE-04-0618-0016, Form 10904, Deletion Requests.)
- (9) Revised Exhibit 4.75.31-5, AIMS Master File Establishments of Converted Tax Returns to reference new procedures for deleting AIMS accounts in IRM 4.75.16.3.1, Deleting AIMS Accounts. (Interim Guidance TEGE-04-0618-0016, Form 10904, Deletion Requests.)

EFFECT ON OTHER DOCUMENTS

This supersedes IRM 4.75.31 dated July 17, 2017.

This incorporates IG Memo TEGE-04-0819-0015, Consolidation of policy statements and delegation orders into two new IRM sections.

This incorporates IG Memo TEGE-04-0419-0011, Elimination of requirement to use Form 5772 on EO examinations and modifications to Form 5773.

This incorporates IG Memo TEGE-04-0618-0016, Form 10904, Deletion Requests.

This incorporates IG Memo Interim Guidance TEGE-04-0517-0019, Procedures Following the TE/GE Reorganization

AUDIENCE

Tax Exempt and Government Entities
Exempt Organizations
Examinations

Margaret Von Lienen
Director, Exempt Organizations
Tax Exempt and Government Entities

4.75.31

Conversion of Returns

Table of Contents

4.75.31.1 Program Scope and Objectives

4.75.31.1.1 Authority

4.75.31.1.2 Responsibilities

4.75.31.1.3 Terms

4.75.31.1.4 Acronyms

4.75.31.1.5 Related Resources - IRMs

4.75.31.1.6 Related Resources - Forms and Pubs

4.75.31.2 Proposed Adverse Status Change

4.75.31.2.1 Proposed Adverse Status Change - Agreed

4.75.31.2.2 Proposed Adverse Status Change - Unagreed

4.75.31.2.3 Form 5599

4.75.31.2.4 Form 2363-A - Primary Return Case File

4.75.31.2.5 Form 3198-A - Primary Return Case File

4.75.31.2.6 Form 5666 - Primary Return Case File

4.75.31.3 Converted Tax Return Secured

4.75.31.3.1 Converted Tax Return Secured - To Be Further Adjusted

4.75.31.3.2 Form 3198-A - Secured Converted Tax Return To Be Adjusted Case File

4.75.31.3.3 The FAST

4.75.31.4 Substitute for Return - Converted Tax Returns

4.75.31.4.1 Form 3198-A - SFCR Case File

4.75.31.5 EO Enforcement Criteria

4.75.31.6 Scope of EO Enforcement

4.75.31.7 Determination of Tax Liability

4.75.31.7.1 Basic Income Tax Considerations

4.75.31.7.2 Gift Tax Consequences

4.75.31.7.3 Effect on Employee Plans

4.75.31.7.4 Effect on Tax Exempt Bonds

4.75.31.7.4.1 Referral to Tax Exempt Bonds (TEB)

4.75.31.8 Statute Protection - Dual Responsibility With Appeals

4.75.31.9 Revocations and Disqualifications - Alternative Positions

Exhibits

4.75.31-1 Form 2363-A – Revocation of IRC 501(c)(3) and Generating 1120 Filing Requirement

4.75.31-2 Form 2363-A – Revocation of PF and Generating Form 1120 Filing Requirement

4.75.31-3 Form 2363-A – Revocation of IRC 501(c)(Other) and Generating Form 1120 Filing Requirement

-
- 4.75.31-4 Summary Instructions for Form 4549 for the Converted Return
 - 4.75.31-5 AIMS Master File Establishments of Converted Tax Returns
 - 4.75.31-6 AIMS NMF Establishments of Converted Tax Returns
 - 4.75.31-7 Form 990 to Form 1120 Conversion Table

4.75.31.1
(10-18-2019)
**Program Scope and
Objectives**

- (1) **Purpose.** This IRM section describes the converted return process in EO Examinations. This manual provides the procedures, guidelines and criteria for soliciting converted tax returns, and establishing and enforcing substitute for converted tax returns. This manual addresses the conversion of primary returns Form 990 or Form 990-EZ to three specific tax returns:
 - Form 1120, U.S. Corporation Income Tax Return.
 - Form 1041, U.S. Income Tax Return for Estates and Trusts.
 - Form 990-PF, Return of Private Foundation or Section 4947(a)(1) Trust Treated as Private Foundation.
- (2) **Audience.** These procedures are directed toward IRS employees authorized to conduct examinations of exempt organizations. This manual is also a key reference for their managers and reviewers, as well as other TE/GE employees in supporting roles.
 - EO examiners.
 - Tax compliance officers.
 - Tax law specialists and reviewers.
 - Tax examiners.
 - Front-line examination group managers.
- (3) **Policy Owner:** Director, Exempt Organizations.
- (4) **Program Owner:** Exempt Organizations.
- (5) **Contact Information:** To recommend changes or make any other suggestions to this IRM section, email the EO Examinations Mandatory Review office at **TEGE EO Review Staff*.

4.75.31.1.1
(10-18-2019)
Authority

- (1) IRC 7602 gives examiners the authority to:
 - a. Examine any books, papers, records or other data necessary to complete an examination.
 - b. Issue a summons for information necessary to complete an examination.
 - c. Take testimony under oath to secure additional information needed.
 - d. Ask about any offense connected with the administration or enforcement of the Internal Revenue laws.
- (2) 26 CFR 301.6020-1 provides guidance to authorized employees for preparing substitute for returns under IRC 6020(b). See Treasury Decision (TD) 9380, 2008-1 C.B. 718.
- (3) Delegation Order 5-2 (Rev. 2) provides that Internal Revenue Agents and Tax Compliance Officers have the authority to prepare and execute returns required by law when the person required to file such returns fails to do so. See IRM 1.2.2.6.2.
- (4) Policy Statement 5-133 "Delinquent returns - enforcement of filing requirements", describes the IRS' policy on delinquent returns and the enforcement of filing requirements. See IRM 1.2.1.6.18.
- (5) Policy Statement 4-63 describes the IRS' policy on no unwarranted adjustments in statutory notices. The policy states the deficiency asserted in a statutory notice of deficiency should be based on meritorious adjustments. No adjustments should be included for punitive, bargaining, or similar purposes.

4.75 Exempt Organizations Examination Procedures

Estimated amounts to protect the Government's interest may be used only when it is impossible to establish exact amounts.

- (6) The authority for EO to enforce income taxes is rooted in:
- Treasury Regulations §601.105(b) of the procedural regulations.
 - Section 2.01(d) of TE/GE Delegation Order (D.O. 18 as authorized by Servicewide D.O. 7-2.
 - IRM 4.75.20.4 (3), Final Case Processing - 90-day Letters.

4.75.31.1.2 (10-18-2019) Responsibilities

- (1) During an examination, examiners are responsible for determining if the organization:
- Meets the requirements for exemption.
 - Has the proper foundation status.
 - Has filed all required tax and information returns.
 - Has reported information and tax liabilities on filed returns completely and accurately.
- (2) Taxpayer Bill of Rights (TBOR): In June of 2014 the IRS adopted the TBOR therefore, examiners are also responsible for:
- a. Conducting a quality examination with fairness and integrity.
 - b. Being familiar with and acting in accord with t/p rights. See IRC 7803(a)(3).

Note: For additional information refer to Policy 1-236.

- (3) Along with their managers, examiners are responsible for controlling and monitoring statutes on their assigned cases.

4.75.31.1.3 (07-17-2017) Terms

- (1) General definitions are as follows:

Term	Definition
Administrative File	The examination case file folder (paper or paperless) for one MFT for one taxpayer, for one or more tax periods under examination, including closing documents, check sheets, reports, returns, workpapers and the administrative record. See IRM 4.75.10.2.1.
Administrative Record	A written record of the administrative proceedings between the IRS and the organization under examination. Examiners prepare an administrative record for all IRC 7428 declaratory judgment cases. See IRM 4.75.32.
Adverse status change	Includes changes in status subject to IRC 7428 declaratory judgment rights, such as a revocation, disqualification of status 36 organizations, or re-classification of foundation status.
Affected Tax Years	The years the adverse status change is effective.

Term	Definition
Agent	For purposes of these instructions, any EO employee authorized to examination returns.
Annual EO Information Return	Form 990 series information returns filed by exempt organizations. Form 990-PF and Form 990-BL are hybrid annual EO information returns and tax returns.
Examination account	An AIMS Master File or NMF record, and a RCCMS record, of an examination of one MFT for one taxpayer, for one tax period.
Examination controls	See Examination account above.
Examination record	See Examination account above.
Case	A return open for examination for one tax period plus other returns, if any, involving interrelated interests or transactions that require concurrent examination. <i>Other returns</i> includes any related return of the same taxpayer and of related taxpayers for any tax period.
Case file	Synonymously used with the examination administrative file.
Closing record	The RCCMS Closing Records tab, and in the case of paper closures, Form 5599.
Conversion	For purposes of this manual, the delinquent or substitute for return process used to convert an annual EO information return to a tax return. See also IRM 4.5.3.14, Conversions.
Converted Tax Return	For purposes of this manual, a tax return converted from an annual EO information return.
Deficiency procedures	The process of preparing, approving, issuing and suspending a 90-day statutory notice of deficiency.

Term	Definition
Disqualification	A loss of tax-exempt status, other than by revocation of a ruling or determination letter, for specified tax years for the following types of organizations: <ol style="list-style-type: none"> 1. Organizations that self-declared their tax-exempt status by filing an annual EO information return. 2. IRC 501(c)(12) or IRC 501(c)(15) organizations that fail their respective 85 percent member income test or gross receipts test for a specific tax year. 3. Organizations treated as tax-exempt under IRC 501(c)(3) without a ruling or determination letter, such as an organization claiming to be a church or a small organization with gross receipts normally not more than \$5,000 per year.
Enforcement	Deficiency procedures within the civil tax administration context.
EO Closing Unit	Formerly the Examination Special Support unit (ESS) in EO Examinations. The EO Closing Unit is under the jurisdiction of the Compliance Planning and Classification (CP&C) in TE/GE.
FAST Envelope	The unsealed envelope containing documents (including a live converted tax return) to be processed with the FAST group once a proposed revocation is sustained by Mandatory Review or Appeals. See IRM 4.75.31.3.3.
Final Revocation	A revocation sustained by Mandatory Review or Appeals after issuance of a 90-day final adverse determination letter (FADL). Revocations can be challenged in the U.S. Tax Court during this 90-day period. Immediately after issuing the FADL however, Mandatory Review will submit Form 2363-A as prepared by the examiner, to the FAST in order update the EOBFM. Mandatory Review will also submit a request for an announcement in the Internal Revenue Bulletin, and submit in redacted form the FADL and the proposed adverse determination letter with Form 886-A to the IRS Electronic Reading Room.
Formal Report	Examiner's formal report consisting of a 30-day letter with RAR, issued for unagreed tax cases and all IRC 7428 cases.
The Group	Unless otherwise specified or suggested by context, the front line examination group or examination group.

Term	Definition
Open Tax Year	A tax year not barred by statute of limitations for assessment.
PATH Act	The Protecting Americans from Tax Hikes Act of 2015, P.L. 114-113.
Primary Return	The annual information return under EO jurisdiction, such as Form 990, 990-EZ, 990-PF or 990-BL. This is the return around which other returns revolve. The primary return also serves as the return of record for statute purposes for certain related tax returns, such as Form 990-T. Note: Form 990-N, not a return, is <i>treated as</i> a primary return for disposal code and principal issue code (PIC) purposes.
Protective Establishment (AIMS)	AIMS NMF establishment of an income tax return pending the outcome of a proposed revocation in Mandatory Review or Appeals. See Exhibit 4.75.31-6. Protective establishments are generally suspended in Mandatory Review.
Related Return	Any return of the same taxpayer, without regard to examination jurisdiction. Discrepancy adjustment returns and Forms 4720-A filed by related persons are <i>treated as</i> related returns for EO examinations.
Revenue Agent's Report	Also known as the Report of Examination or Examination Report.
Review function	A general term describing either the EO Examinations Mandatory Review group or Special Review group.
Secondary return	Any return <i>other than</i> a primary return.
Short statute return	A return with less than 270 days remaining on the ASED.
Statute	Unless stated otherwise in this manual, the term denotes the assessment statute expiration date (ASED).
Statute Controls	See IRM 4.75.16.4.2.1 for a description of statute controls.
Status 36 Organization	An organization, other than one described under IRC 501(c)(3), (c)(9), (c)(17) and (c)(29), that self-declared its tax-exempt status on a filed Form 990, 990-EZ or 990-N.

Term	Definition
Substitute for Converted Return (SFCR)	A substitute for return prepared by the examiner in order to initiate deficiency procedures for tax after an organization loses its tax-exempt status or becomes a private foundation. The actual SFCR consists of Form 13496, IRC 6020(b) Certification and the RAR. See IRM 4.75.31.4.1.
Suspended Tax Case	See Protective Establishment (AIMS) above.

4.75.31.1.4
(10-18-2019)
Acronyms

(1) The table below lists the commonly used acronyms and their definitions:

Acronym	Definition
AIMS	Audit Information Management System
ARDI	Accounts Receivable Delinquent Inventory
ASED	Assessment Statute Expiration Date
BMF	Business Master File
BOD	Business Operating Division
DC	Disposal Code
EIN	Employer Identification Number
EO	Exempt Organizations
EOBMF	Exempt Organizations Business Master File
FADL	Final Adverse Determination Letter
FAST	Field Agent Support Team
FUTA	Federal Unemployment Tax Act
IDRS	Integrated Data Retrieval System
IRC	Internal Revenue Code
LB&I	Large Business and International Business Operating Division
MF	Master File
MFT	Master file tax code
MT	Manual Transmittal
NMF	Non-Master File
NOL	Net Operating Loss
PF	Private Foundation
PIC	Principal Issue Code

Acronym	Definition
PII	Personally Identifiable Information
RAR	Revenue Agent's Report
RCCMS	Reporting Compliance Case Management System
SB/SE	Small Business/Self Employed Business Operating Division
SFCR	Substitute for Converted Return
SFR	Substitute for Return
SNOD	Statutory Notice of Deficiency
SRS	Specialist Referral System
TAM	Technical Advice Memorandum
TC	Transaction Code
T.C.	Tax Court
TE/GE	Tax Exempt and Government Entities Business Operating Division
TEB	Tax-Exempt Bonds
TIN	Taxpayer Identification Number
UBIT	Unrelated Business Income Tax

4.75.31.1.5
(07-17-2017)

Related Resources - IRMs

- (1) EO Examinations IRMs mentioned in this manual include:
 - IRM 4.75.13, Issue Development and Conclusions.
 - IRM 4.75.15, EO Closing Letters and Audit Reports.
 - IRM 4.75.16, Case Closing Procedures.
 - IRM 4.75.20, Final Case Processing.
 - IRM 4.75.22, EO Delinquent, Amended, and Substitute for Return Procedures.
 - IRM 4.75.32, Declaratory Judgment Cases And The Administrative Record.
- (2) TE/GE IRMs mentioned in this manual include:
 - IRM 4.5.1, TE/GE AIMS Processing.
 - IRM 4.5.3, TE/GE AIMS Special Processing Procedures.
- (3) Servicewide and other BOD IRMs mentioned in this manual include:
 - IRM 1.2.1.4, Policy Statements for Submission Processing Activities.
 - IRM 4.10.8, Examination of Returns, Report Writing.
 - IRM 4.11.6, Changes in Accounting Methods.

4.75 Exempt Organizations Examination Procedures

4.75.31.1.6
(07-17-2017)

Related Resources - Forms and Pubs

- (1) The following paragraphs list the forms and publications referenced in this manual. For a comprehensive list of forms relevant to EO examiners, see IRM 4.75.16.1.6.
- (2) Publications and Documents:
 - Document 6379, Information Systems Codes FY 201X Quick Reference for EO Employees.
 - Document 13056, Shipping Procedures for PII.
- (3) AIMS forms:
 - Form 5588, TE/GE Non-Master File Request.
 - Form 5597, TE/GE IMF/BMF/EPMF Request.
 - Form 5599, TE/GE Examined Closing Record.
- (4) Tax and information return forms:
 - Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return.
 - Form 941, Employer's Quarterly Federal Tax Return.
 - Form 990, Return of Organization Exempt From Income Tax.
 - Form 990-BL, Information and Initial Excise Tax Return for Black Lung Benefit Trusts and Certain Related Person.
 - Form 990-EZ, Short Form Return of Organization Exempt From Income Tax.
 - Form 990-N, Electronic Notice (e-Postcard) for Tax-Exempt Organizations Not Required to File Form 990 or Form 990-EZ.
 - Form 990-PF, Return of Private Foundation or Section 4947(a)(1) Trust Treated as Private Foundation.
 - Form 990-T, Exempt Organization Business Income Tax Return.
 - Form 1120, U.S. Corporation Income Tax Return.
 - Form 1120-POL, U.S. Income Tax Return for Certain Political Organizations.
 - Form 1041, U.S. Income Tax Return for Estates and Trusts.
- (5) Waiver and acceptance forms:
 - Form 870, Waiver of Restrictions on Assessment & Collection of Deficiency in Tax & Acceptance of Overassessment.
 - Form 870-E, Waiver of Restriction on Assessments and Collection of Deficiency and Acceptance of Overassessment.
 - Form 4549, Income Tax Examination Changes.
 - Form 6018, Consent to Proposed Action.
- (6) Basic report forms:
 - Form 886-A, Explanation of Items.
 - Form 4549, Income Tax Examination Changes.
 - Form 4549-A, Income Tax Examination Changes (Unagreed and Excepted Agreed).
 - Form 4621, Exempt Organizations - Report of Examination.
 - Form 4621-A, Exempt Organizations - Report of Examination (Proposed Status Changes).
- (7) Delinquent return forms, SFR forms, filing requirement forms:

- Form 2363-A, Request for IDRS Input for BMF/EO Entity Change.
- Form 3198-A, TE/GE Special Handling Notice.
- Form 3210, Document Transmittal.
- Form 3244-A, Payment Posting Voucher - Examination.
- Form 10321, Fax Transmission Cover Sheet.
- Form 13133, Expedite Processing Cycle.
- Form 13496, IRC Section 6020(b) Certification.

(8) Case closing forms:

- Form 2363-A, Request for IDRS Input for BMF/EO Entity Change.
- Form 3198-A, TE/GE Special Handling Notice.
- Form 3210, Document Transmittal.
- Form 5346, Examination Information Report.
- Form 5599, TE/GE Examined Closing Record.
- Form 5666, TE/GE Referral Information Report.
- Form 10904, Request for Record Deletion from AIMS.

(9) Workpaper forms:

- Form 5464, Case Chronology Record.
- Form 5773, EO Workpaper Summary.
- Form 5774, Private Foundation Workpapers.

4.75.31.2
(07-17-2017)
**Proposed Adverse
Status Change**

(1) For purposes of this manual, an “adverse status change” includes:

- A revocation.
- A disqualification of a status 36 organization.
- A reclassification from a public charity to a private foundation.

Note: All are subject to mandatory review with declaratory judgment rights.

(2) If a proposed adverse status change appears likely during the examination:

- Establish the primary return for subsequent tax years, *unless* the facts and circumstances warrant not establishing those years.
- Document the facts and circumstances for not expanding the primary return examination to subsequent tax years.
- Prepare an administrative record.

Note: Consider examination cycle time, statute of limitations, and available resources

. Also, consider the extent of voluntary correction of non-compliant activities in subsequent tax years.

(3) If you expand the primary return examination to include subsequent tax years, you can focus that examination to determining:

- The extent the noncompliant activities continue or were voluntarily corrected.
- The potential converted tax liability (see IRM 4.75.31.7) for each affected tax year, or
- Both.

4.75 Exempt Organizations Examination Procedures

- (4) Follow these additional instructions for preparing an adverse status change report and closing the case:
- See IRM 4.75.15 for preparing a 30-day letter and RAR.
 - See IRM 4.75.31.9 for including alternate positions in a revocation RAR if the revocation is not upheld.
 - See IRM 4.75.16.4.4 for preparing a closing record, with disposal codes and PICs.
 - See IRM 4.75.32 for preparing an administrative record when there are indications of a proposed adverse status change.
- (5) An “adverse status change” requires taking the steps necessary to protect the assessment of the tax resulting from the adverse status change for the affected tax years by either:
- Preparing Form 5666 information report (see IRM 4.75.31.2.6).
 - Conversion of the primary return (see next paragraph).

Note: Form 5666 is not needed for a revoked private foundation nor for reclassifying a public charity to a private foundation.

Note: However, you can prepare Forms 5666 for other tax years, other returns and other persons.

- (6) A conversion is accomplished by either of the following actions:
- Securing a “converted tax return” accepted as filed (see IRM 4.75.31.3).
 - Adjusting the secured converted tax return (deficiency procedures) (see IRM 4.75.31.3.1).
 - Establishing an SFR (deficiency procedures) (see IRM 4.75.31.4).
- (7) To help you decide how to bring an organization current, review:
- Enforcement criteria in IRM 4.75.31.5 and IRM 4.75.22.6.
 - Guidance for determining income tax in IRM 4.75.31.7 and IRM Exhibit 4.75.31-7.
- (8) “Converted tax returns” addressed in this manual include:
- Form 1120, for revocations and disqualifications, including revocation of a private foundation.
 - Form 1041, for revocations and disqualifications, including revocation of a private foundation.
 - Form 990-PF, for reclassifications from a public charity to a private foundation.

Note: If you are both reclassifying a public charity to a private foundation and revoking its tax-exempt status, the converted tax return will be Form 1120 or Form 1041.

A separate report can be issued for proposed Chapter 42 excise taxes including IRC 4940 tax after Mandatory Review or Appeals sustains both actions.

4.75.31.2.1
(07-17-2017)
**Proposed Adverse
Status Change - Agreed**

- (1) A proposed adverse status change prepared in accordance with IRM 4.75.15 is agreed when the organization signs Form 6018. Filing a converted tax return or paying the tax does not constitute an agreement.
- (2) Solicit converted tax returns for all affected tax years not barred for assessment. Affected tax years are the years the adverse status change is effective.
 - a. Generally give the organization no more than 30 days to file their converted tax return with you.
 - b. You are not required to hold the primary return case file in group inventory waiting for converted tax returns.

Note: Refer to IRM 4.75.31.3 for processing a secured converted tax return.

Note: If you are reclassifying the organization from a public charity to a private foundation

, you can also solicit or prepare SFRs for Form 4720 or 4720-A for IRC 4941 - 4945 taxes if they are required.

- (3) Bring the organization current on its tax and filing obligations for the affected tax years as stated in IRM 4.75.31.2 (5).
- (4) Prepare the following closing documents for the primary return case file:
 - Form 5599 for closing the case (see IRM 4.75.31.2.3).
 - Form 2363-A for posting the adverse status change and change in filing requirement (see IRM 4.75.31.2.4).
 - Form 3198-A for special handling of the primary return case file (see IRM 4.75.31.2.5).
 - Form 5666 if you decided not to employ deficiency procedures (see IRM 4.75.31.2.6).

4.75.31.2.2
(07-17-2017)
**Proposed Adverse
Status Change -
Unagreed**

- (1) **Don't** solicit converted tax returns for unagreed adverse status changes.
- (2) If the organization files a converted tax return with you, follow the same procedures for agreed revocations in IRM 4.75.31.2.1.

Note: The organization may want to minimize interest on unpaid tax, or prefer to pay the tax and contest the revocation in U.S. District Court or the U.S. Claims Court at some future date, after you deny their claim for refund.

- (3) Take the steps necessary to protect the assessment of the tax resulting from the adverse status change for the affected tax years. See IRM 4.75.31.2 (5). If you decide to enforce the tax, you can:
 - Establish the converted tax return on AIMS NMF and
 - Inform the organization of the potential income tax filing requirement and liability pending a final determination on the exempt status.

Note: You only propose an income tax or solicit a converted tax return *after* Mandatory Review or Appeals sustains the adverse status change.

- (4) Prepare the following closing documents for the primary return case file:

4.75 Exempt Organizations Examination Procedures

- Form 5599 for closing the case (see IRM 4.75.31.2.3).
- Form 2363-A for posting the adverse status change and change in filing requirement (see IRM 4.75.31.2.4).
- Form 3198-A for special handling of the primary return case file (see IRM 4.75.31.2.5).
- Form 5666 if you decided not to employ deficiency procedures (see IRM 4.75.31.2.6.).

4.75.31.2.3 (07-17-2017) Form 5599

- (1) For agreed adverse status changes, you can use either one of the following disposal codes, unless a higher priority disposal applies:
 - DC 09 (211), Agreed Revocation.
 - DC 13 (501), Referrals to Other Operating Divisions (applicable for agreed disqualifications).
 - DC 17 (203), Change in Foundation Status (applicable for reclassification of a public charity to a private foundation).
- (2) For unagreed adverse status changes, you can use either one of the following disposal codes, unless a higher priority disposal applies:
 - DC 07 (601), Unagreed - Protest to Appeals.
 - DC 55 (605), Unagreed Revocation Without Protest.
 - DC 10 (604), Unagreed - Without Protest.
 - DC 15 (602), Church Examination - Unagreed.
- (3) Refer to IRM 4.75.16.4.4 for more Form 5599 closing record instructions.

4.75.31.2.4 (07-17-2017) Form 2363-A - Primary Return Case File

- (1) Prepare Form 2363-A for every adverse status change case file (primary return case file).
- (2) Follow the instructions in Exhibit 4.75.31-1, Exhibit 4.75.31-2 and Exhibit 4.75.31-3.
- (3) You can also refer to IRM Exhibit 4.75.16-.5, IRM Exhibit 4.75.16-6 and IRM 25.7.1 for more information.

4.75.31.2.5 (07-17-2017) Form 3198-A - Primary Return Case File

- (1) Prepare Form 3198-A for every adverse status change case file (primary return case file).
- (2) Enter one or more of the following notations if applicable in "Other Instructions" or under the "Mandatory Review" check box before transferring the case file to Mandatory Review:
 - If there is a POA, check the box for "*Send All Communications Per POA.*"
 - "*Process Form 2363-A [and Form 5666] if Revocation [Disqualification or Reclassification to PF] is Sustained.*"
 - "*Process Converted Form [1120, 1041, or 990-PF] Only If Revocation [Disqualification or Reclassification to PF] is Sustained.*"
 - Under the Mandatory Review check box, "*Agreed Revocation [Disqualification or Reclassification to PF].*"
 - Under the Mandatory Review check box, "*Unagreed Revocation [Disqualification or Reclassification to PF] - With [Without] Protest.*"
 - Check the "*Forward to Appeals*" box.

- Notate for Appeals: *“Notify EO Exams if TP Intends Not to Extend Statute - Converted Tax Return in Suspense Pending Final Revocation [Disqualification or Reclassification to PF].”*
- For IRC 501(c)(3) revocations, enter *“Notify State Officials Under IRC 6104(c).”*
- *“If Revocation [Disqualification] is Sustained, Transfer Payments Applied to 990-T Module for the Revoked [Disqualified] Tax Years to the Converted 1120 [1041 or 990-PF] Module - Then Reverse Tax Assessments on 990-T Tax Module.”*
- Indicate the reason for not enforcing a converted tax return tax in Other Instructions. See IRM 4.75.31.5.

- (3) Place Form 3198-A on the outside cover of the primary return case file folder on top of Form 5599.

Note: Refer to IRM 4.75.31.3.2 for instructions on Form 3198-A for the secured converted tax return to be adjusted case file.

Note: Refer to IRM 4.75.31.4.1 for instructions on Form 3198-A for the SFCR case file.

4.75.31.2.6
(07-17-2017)
**Form 5666 - Primary
Return Case File**

- (1) This course of action follows your evaluation in IRM 4.75.31.2 (5), where you decide to prepare a Form 5666. See instructions at IRM Exhibit 4.5.1-14 and IRM Exhibit 4.75.16-8.
- (2) Use Form 5666 to recommend an examination of the organization that loses its exempt status for the affected tax years, and subsequent years if needed. Include the following information on Form 5666:
- A statement that the organization’s exemption has been revoked (or disqualified).
 - The effective date of the revocation (or affected tax years for disqualifications).
 - The date the organization was incorporated or created.
 - A statement that, as a taxable entity, the organization should be reporting income tax, FUTA tax or excise taxes for which it may be liable.
 - A list of the converted tax returns secured by the examiner (include form number, MFT, tax period).
 - A statement whether the original converted tax returns were submitted for processing.
 - A statement that contributions to the organization are no longer deductible as charitable contributions (IRC 170(c) organizations only).
 - List the names and TINs of insiders whose deductions for contributions should be disallowed.

Note: A contributor can’t deduct contributions effective the date the revocation is announced in the IRB. However, certain contributors also can’t deduct contributions prior to that date if the contributor:

4.75 Exempt Organizations Examination Procedures

1. Had knowledge of the revocation of the ruling or determination letter,
2. Was aware that such revocation was imminent or
3. was in part responsible for, or was aware of, the activities or deficiencies on the part of the organization which gave rise to the revocation.

See Treas. Reg. §1.509(a)-7(a) and Rev. Proc. 2011-33, 2011-1 C.B. 887, which supersedes and modifies Rev. Proc. 82-39, 1982-2 C.B. 759 and Rev. Proc. 2009-32, 2009-28 I.R.B. 142.

(3) Attach the following documents to Form 5666:

- A copy of the report of examination proposing a revocation (or disqualification).
- A copy of the of the annual EO information returns for the affected tax years; e.g., Form 990.
- A copy of any converted tax returns if filed.
- Any other pertinent information or documents.
- A copy of the 90-day FADL (attached by Mandatory Reviewer).

(4) For additional instructions on preparing Form 5666, see IRM 4.75.16.4.8. You can also use Form 5346 if you prefer that form.

(5) Place the Form 5666 package on the inside-left of the primary return case file folder.

4.75.31.3
(07-17-2017)

Converted Tax Return Secured

(1) Receiving and securing a converted tax return normally follows:

- Your solicitation for the converted tax return in IRM 4.75.31.2.1 (1) or
- An unexpected filing of a converted tax return in IRM 4.75.31.2.2 (2).

Caution: Secured converted tax returns will have an ASED based on the filing of Form 990 or 990-EZ.

(2) Follow delinquent return procedures in IRM 4.75.22.4 except that you will:

- Mark the top margin of the converted tax return in red, "*Form 990 Converted to Form [1120 or 1041 or 990-PF] by TE/GE.*"
- Generally don't impose delinquency penalties if the underlying primary return was filed in good faith. See also IRM 4.75.22.4.2.
- Not send the return to the FAST.

(3) Prepare a "converted tax return package," for the filed return which includes the following forms:

- Form 13133.
- Form 3198-A.
- A *copy* of the payment instrument (check, cashiers check, etc.).
- A *copy* of Form 3244-A.
- A *copy* of the taxpayer's written penalty relief request.
- The original return.

- Double envelopes addressed to the FAST. See IRM 4.75.31.3.3. **Don't** seal the envelopes.

Note: The unsealed converted tax return package will ride with the primary return case file to Mandatory Review.

- (4) If you receive and secure a converted tax return after you closed your primary return case file to Mandatory Review, follow these instructions:

If...	Then...
The underlying adverse status change has not yet posted per INOLES	<p>Follow the converted tax return procedure in IRM 4.75.31.3 (2) and IRM 4.75.31.3 (3). Send the converted tax return package to Mandatory Review to associate with the primary return case file.</p> <p>Charge this time to 610-0999, or charge time to the converted tax return if you established it for adjustment.</p>
The underlying adverse status change <u>has</u> posted per INOLES	<p>Follow delinquent return procedures for the converted tax return, and send to the FAST for processing.</p> <p>Charge this time to 610-0999, or charge time to the converted tax return if you established it for adjustment.</p>

- (5) If you secured the converted tax return after a TC 150 already posted an SFR, follow the instructions in IRM 4.75.31.4 (8).
- (6) Decide whether to accept the converted tax return as filed, or whether you will prepare Form 5666 or adjust the return yourself. Consider:
- Information obtained during your examination of the primary return.
 - The primary return information for the years of examination and subsequent years.
 - Enforcement criteria in IRM 4.75.31.5 and IRM 4.75.22.6.
 - Guidance for determining income tax in IRM 4.75.31.7 and IRM Exhibit 4.75.31-7.
- (7) If the underlying adverse status change is sustained by Mandatory Review or Appeals, Mandatory Review will:
- Issue a 90-day FADL (Appeals is authorized to issue a FADL).
 - Sign and forward Form 2363-A (located in the primary return case file) to the FAST for processing.
 - Forward Form 5666 to the EO Referrals group via the EO Closing Unit, after the 90 days plus 15 days expires.
 - Forward the original converted tax return package to the FAST for processing.
 - If applicable, send converted tax return case file in status 38 suspense back to you to adjust the return.

4.75 Exempt Organizations Examination Procedures

(8) If the underlying adverse status change is **not** sustained by Mandatory Review or Appeals, Mandatory Review will:

- Send the converted tax return package back to you. The return is unpostable.
- Destroy Form 2363-A and Form 5666.

Note: Send the converted tax return back to the organization with a cover letter informing them that the converted tax return is unpostable due to the continuation of tax-exempt status or public charity status. Amounts paid with the converted tax return will either be refunded or credited to other accounts. Contact the FAST via email to ensure that the amounts paid with the secured converted tax return are refunded or applied to other tax accounts. See IRM 4.75.31.3.2

4.75.31.3.1
(10-18-2019)

Converted Tax Return Secured - To Be Further Adjusted

(1) This course of action follows your evaluation in IRM 4.75.31.3 (6), where you determine enforcement is needed by adjusting a secured converted tax return.

Caution: Secured converted tax returns will have an ASED based on the filing of Form 990 or 990-EZ.

(2) If you know the return is substantially incorrect or incomplete, give the organization an opportunity to submit a correct return if time permits for purposes of the ASED.

Note: If the organization insists on filing the incorrect return, collect the return subject to examination adjustment. If you believe the return to be fraudulent, consult with the Fraud Technical Advisor.

See IRM 4.75.35.

(3) Establish the secured converted tax return for adjustment on:

- AIMS NMF if the underlying adverse status change is **not** posted to the EOBFM (see Exhibit 4.75.31-6).
- AIMS MF if the underlying adverse status change is posted to the EOBFM (see Exhibit 4.75.31-5).

(4) The NMF case file will:

- Have its own Forms 3198-A, 5464, 5773 or their RCCMS equivalents, working return assembly, and workpapers. See IRM 4.75.31.3.2.
- Include a copy of the primary return marked "Copy - Do Not Process."
- Follow case file assembly procedures in IRM 4.75.16.7.
- Include workpapers to support amounts per examination that are different from those reported on the primary return.
- Ride with the primary return case file to Mandatory Review to be placed in suspense Status 38 until the underlying proposed adverse status change is sustained.
- Have statute dates based on the filing of the underlying primary return of record.

Note: Mandatory Review will only hold the NMF converted tax return case file in Status 38 suspense until there are 270 days remaining on the ASED. Thereafter the reviewer will send the converted income tax case back to the examiner to initiate

statute controls while the adverse status change remains unresolved. **Don't** suspend the NMF case file with AIMS Status Code 39. During the short statute period, you and your manager will decide when to initiate deficiency procedures on NMF in order to protect the statute of limitations for assessment, even if the revocation is not final. Consult with Area Counsel regarding the issuance of a statutory notice of deficiency if the ASER is less than 270 days.

(5) You can obtain NMF transcripts as follows:

- Fax your request to the Accounting Operations Department in Covington, KY, at 859-669-2959.
- Use Form 10321, Fax Transmission Cover Sheet.
- State on the cover sheet, *"Please provide a NMF transcript for XYZ Corporation; EIN 12-3456789; MFT 66; Tax period 201111"*.
- Call 859-669-5498 to follow-up on your request.

(6) If the underlying adverse status change is sustained by Mandatory Review or Appeals:

- a. Mandatory Review will forward the converted tax return package to the FAST for processing.
- b. Mandatory Review will also send the NMF case file back to you to initiate deficiency procedures.
- c. Initiate deficiency procedures:

Adjusting the Secured Converted Tax Return:	
Form 1120 or Form 1041 - Income Tax	Form 990-PF - IRC 4940 Tax
Based on Revocation or Disqualification	Based on Reclassification to a Private Foundation
Letter 950 Form 870 Form 4549-A Form 886-A Pub 3498 Pub 594 Reference: IRM 4.75.15.8.4	Letter 3614 Form 4621 Form 4883 Form 870-E Form 886-A Pub 3498 Pub 594 Reference: IRM 4.75.15.8.6 See paragraph (9) of this subsection.

- d. After the underlying adverse status change posts to the EOBF, establish the converted tax return on AIMS MF, Push Code 020. See Exhibit 4.75.31-5.
- e. Delete the duplicate NMF account. Follow deletion instructions in IRM 4.75.16.3.1, Deleting AIMS Accounts.

(7) If the underlying adverse status change is not sustained by Mandatory Review or Appeals:

4.75 Exempt Organizations Examination Procedures

- a. Follow the workflow in IRM 4.75.31.3 (8) with respect to disposition of the secured converted tax return package.
 - b. Mandatory review will also send the NMF converted tax return case file back to you.
 - c. Delete the NMF examination account. Follow deletion instructions in IRM 4.75.16.3.1, Deleting AIMS Accounts.
- (8) After initiating deficiency procedures in subparagraph (6)c, close the converted tax return case file as follows:

Closing the Converted Tax Return, as Adjusted		
#	If the organization...	Then...
1.	Agrees	<ol style="list-style-type: none"> 1. Stamp the received date on Form 870 or Form 870-E. 2. Issue Letter 3607, with copy of signed waiver form. 3. Prepare Form 5599 for converted tax return, DC 03 (102). 4. Complete ARDI Code, Item 42, on Form 5599. 5. Close tax case to the EO Closing Unit. Reference IRM 4.75.15.8.4 and IRM 4.75.15.8.6
2.	Fails to reply	<ol style="list-style-type: none"> 1. Prepare Form 5599 for converted tax return, DC 10 (604). 2. Close tax case to Mandatory Review to issue the SNOD.
3.	Disagrees - Provides NO new information, or provides additional information that does not change your report	<ol style="list-style-type: none"> 1. Issue Letter 5326 rebuttal to organization. 2. Prepare Form 5599, for converted tax return, DC 07 (601) or DC 10 (604). 3. Close tax case to Mandatory Review to issue the SNOD. Reference IRM 4.75.15.12
4.	Disagrees -Provides additional information showing no tax adjustment was necessary	<ol style="list-style-type: none"> 1. Issue Letter 5332. 2. Prepare Form 5599, for converted tax return, DC 02 (107). 3. Close tax case to the EO Closing Unit. Reference IRM Exhibit 4.75.15-1

#	If the organization...	Then...
5.	Disagrees - Provides additional information that decreases the tax	<ol style="list-style-type: none"> 1. Issue a corrected RAR only. Don't issue a new 30-day letter. 2. Issue Letter 5326 rebuttal to organization over the part of the deficiency that remains unchanged. 3. Prepare Form 5599 for converted tax return, DC 07 (601) or DC 10 (604). 4. Close tax case to Mandatory Review to issue the SNOD. Reference IRM 4.75.15.7.2
6.	Disagrees - Provides additional information that increases the tax	<ol style="list-style-type: none"> 1. Issue a new 30-day letter Letter 950 or Letter 3614 and a corrected RAR. 2. Suspend tax case for 30 days pending reply to new proposal. 3. Refer back to this table after organization responds. Reference IRM 4.75.15.7.2, IRM 4.75.15.8.4 and IRM 4.75.15.8.6,

- (9) With respect to an adjustment to a Form 990-PF converted tax return in subparagraph (6)c, the adjustment need not be limited to IRC 4940 tax, which **is** subject to deficiency procedures. You can also adjust non-tax items, such as the reported distributable amount, qualifying distributions, or undistributed income. If adjusting non-tax items is the only adjustment, the adjustment is subject to a nonstandard 30-day letter, with protest to Appeals, but **not** subject to issuance of a final 90-day letter by Mandatory Review. Consult with **TEGE EO Review Staff* on a nonstandard 30-day letter. Any IRC 4942 tax resulting from non-tax adjustments is reported separately on Form 4720, which **is** subject to full deficiency procedures.

4.75.31.3.2
(07-17-2017)

**Form 3198-A - Secured
Converted Tax Return To
Be Adjusted Case File**

- (1) Prepare Form 3198-A for every Converted Tax Return case file. Enter one or more of the following notations if applicable in "Other Instructions" or under the "Mandatory Review" check box on Form 3198-A before transferring the case file to Mandatory Review:
- Check the box for "Send All Communications Per POA."
 - Check the box for "Mandatory Review" and enter "Unagreed Income Tax Deficiency."
 - Check the box for "Forward to Appeals."
 - At Special Features: Indicate "Place Converted Tax Return Case In Mandatory Review Suspense (Status 38) Pending Outcome of Revocation [Disqualification or Reclassification to PF]."
 - Indicate "Assess Tax Per Form 4549 [Form 4883] – Exempt Status Revoked [Disqualified] or [501 (c)(3) Reclassified as a PF]."
 - At the "Earliest Statute Date" section, *The Statute Starts With Filing of Form 990 [990-EZ, 990-PF, 990-BL] on [Date] and Expires [ASED].*
 - Check the box for "Forward to Appeals."
 - "Transfer Payments Applied to 990-T Module for the Revoked [Disqualified] Tax Years to the Converted 1120 [1041] Module - Then Reverse Tax Assessments on 990-T Tax Module."

4.75 Exempt Organizations Examination Procedures

- (2) Place this Form 3198-A on the outside cover of the converted tax return case file folder on top of Form 5599.

Note: Refer to IRM 4.75.31.2.5 for instructions on Form 3198-A for the primary return case file.

Note: Refer to IRM 4.75.31.4.1 for instructions on Form 3198-A for the SFCR case file.

4.75.31.3.3 (10-18-2019) The FAST

- (1) The FAST envelopes will contain the secured converted tax return package to be processed by the FAST if the underlying proposed adverse status change is sustained by Mandatory Review or Appeals.
- (2) For security reasons, prepare two envelopes:
- First envelope addressed to the FAST, to enclose the contents above.
 - Second envelope addressed to the FAST, to enclose first envelope and its contents.
- (3) Do NOT seal the envelopes. Both envelopes should be addressed to the FAST:

FAST U.S. Postal Service Address and UPS Address	
Tax Exempt & Government Entities - FAST Attention: FAST M/S 1114 1973 Rulon White Blvd. Ogden, UT 84201-0252	
FAST Contact Numbers and E-mail Address:	
FAST e-Fax Number	877-814-2236
FAST e-mail address	*TEGE FAST

- (4) The secured converted tax return package and the FAST envelopes ride with EO primary return case file folder until the underlying adverse status change is determined.
- (5) For additional instructions on secure shipping procedures and use of Form 3210, see IRM 4.75.16.9.

4.75.31.4 (07-17-2017) Substitute for Return - Converted Tax Returns

- (1) This course of action follows your evaluation in IRM 4.75.31.2 (5) and IRM 4.75.31.2 (6), where you determine an SFCR is required. No converted tax return was filed.

Caution: The SFCR will have an ASER based on the filing of Form 990 or 990-EZ.

- (2) The decision to initiate deficiency procedures requires managerial approval.
- (3) Establish the SFCR on NMF pending finality of adverse status change. Managerial approval is required. See Exhibit 4.75.31-6.
- (4) The NMF case file will:

- Have its own Form 3198-A, Form 5464, Form 5773 or their RCCMS equivalents, working return assembly, and supporting workpapers.
- Include a copy of the primary return marked “Copy - Do Not Process.”
- If actual amounts per examination are different from those reported on the primary return, include workpapers to support such amounts.
- Follow case file assembly procedures in IRM 4.75.16.7.
- Ride with the primary return case file to Mandatory Review to be placed in suspense Status 38 until the underlying proposed adverse status is sustained.
- Contain a substitute for converted tax return with a statute based on the filing of the underlying primary return of record.

Note: Mandatory Review will only hold the NMF converted tax return case file in Status 38 suspense until there are 270 days remaining on the ASER. Thereafter the reviewer will send the income tax case back to the examiner to initiate statute controls while the adverse status change remains unresolved. **Don’t** suspend the NMF case file with AIMS Status Code 39. During the short statute period, you and your manager will decide when to initiate deficiency procedures on NMF in order to protect the statute of limitations for assessment, even if the revocation is not final. Consult with Area Counsel regarding the issuance of a statutory notice of deficiency if the ASER is less than 270 days.

(5) You can obtain NMF transcripts as follows:

- Fax your request to the Accounting Operations Department in Covington, KY, at 859-669-2959.
- Use Form 10321, Fax Transmission Cover Sheet.
- State on the cover sheet, “Please provide a NMF transcript for XYZ Corporation; EIN 12-3456789; MFT 66; Tax period 201111.”
- Call 859-669-5498 to follow-up on your request.

(6) If the underlying adverse status change **is sustained** by Mandatory Review or Appeals:

- a. Mandatory Review or Appeals will issue a 90-day FADL.
- b. Mandatory Review will sign and forward Form 2363-A (located in the primary return case file) to the FAST for processing.
- c. Mandatory Review will forward Form 5666 to the EO Referrals group via the EO Closing Unit, after the 90 days plus 15 days expires.
- d. Mandatory Review will send the NMF case file back to you to initiate deficiency procedures.
- e. Initiate deficiency procedures:

4.75 Exempt Organizations Examination Procedures

Converted Tax Return SFCR Adjustment:	
Form 1120 or Form 1041 - Income Tax	Form 990-PF - IRC 4940 Tax
Based on Revocation or Disqualification	Based on Reclassification to a Private Foundation
Letter 950 Form 870 (only if using Form 4549-A) Form 4549-A Form 886-A Pub 3498 Pub 594 Reference: IRM 4.75.15.8.4	Letter 3614 Form 870-E Form 4621 Form 4883 Form 886-A Pub 3498 Pub 594 Reference: IRM 4.75.15.8.6

- f. After the underlying adverse status change posts to the EOBFM, follow IRM 4.75.22.7 for establishing SFRs on AIMS MF, Push Code 036. See also Exhibit 4.75.31-5.
 - g. Follow SFR Package procedures in IRM 4.75.22.7.1.
 - h. Delete the duplicate NMF account for the NMF case file. Follow deletion instructions in IRM 4.75.16.3.1, Deleting AIMS Accounts.
- (7) After initiating deficiency procedures in IRM 4.75.31.4 (6) e, close the SFCR as follows:

Closing the Converted Tax Return (SFCR)		
#	If the organization...	Then...
1.	Agrees	<ol style="list-style-type: none"> 1. Stamp the received date on Form 4549 (or Form 870-E). 2. Issue Letter 3607. 3. Prepare Form 5599 for the SFCR, DC 03 (102). 4. Complete ARDI Code, Item 42, on Form 5599. 5. Close tax case to the EO Closing Unit. Reference IRM 4.75.22.7.2.
2.	Fails to reply	<ol style="list-style-type: none"> 1. Prepare Form 5599 for the SFCR, DC 10 (604). 2. Close tax case to Mandatory Review to issue the SNOD. Reference IRM 4.75.22.7.3.

#	If the organization...	Then...
3.	Disagrees - Provides NO new information, or provides additional information that does not change your report	<ol style="list-style-type: none"> 1. Issue Letter 5326 rebuttal to organization. 2. Prepare Form 5599, for the SFCR, DC 07 (601) or DC 10 (604). 3. Close tax case to Mandatory Review to issue the SNOD. Reference IRM 4.75.22.7.3.
4.	Disagrees -Provides additional information showing no tax adjustment was necessary	<ol style="list-style-type: none"> 1. Issue Letter 5332. 2. Prepare Form 5599, for the SFCR, DC 02 (107). 3. Close tax case to the EO Closing Unit. Reference IRM 4.75.22.7.3.
5.	Disagrees - Provides additional information that decreases the tax	<ol style="list-style-type: none"> 1. Issue a corrected RAR only. Don't issue a new 30-day letter. 2. Issue Letter 5326 rebuttal to organization over the part of the deficiency that remains unchanged. 3. Prepare Form 5599 for the SFCR, DC 07 (601) or DC 10 (604). 4. Close tax case to Mandatory Review to issue the SNOD. Reference IRM 4.75.22.7.3.
6.	Disagrees - Provides additional information that increases the tax	<ol style="list-style-type: none"> 1. Issue a new 30-day letter Letter 950 (or Letter 3614) and a corrected RAR. 2. Suspend tax case for 30 days pending reply to new proposal. 3. Refer back to this table after organization responds. Reference IRM 4.75.22.7.3.

- (8) After initiating deficiency procedures in IRM 4.75.31.4 (6) e, close the SFCR as follows if you secure a converted tax return:

Closing the Converted Tax Return (SFCR) Organization Responds to Your Converted Tax Proposal by <u>Filing</u> a Converted Tax Return Reference: IRM 4.75.22.7.4		
#	If...	Then...

7.	You accept the tax return as filed	<p>The Matter of Processing the Converted Tax Return:</p> <ol style="list-style-type: none"> 1. Follow delinquent return procedures. 2. Submit return to the FAST after the adverse status change posts to the EOBF. <p>The Matter of Your Adjustment to the Tax Return:</p> <ol style="list-style-type: none"> 1. Issue Letter 5334. 2. Prepare Form 5599 for converted tax return, DC 06 (208). 3. Enter ARDI Code, Item 42, Form 5599. 4. Enter Items 35 and 37, Form 5599. 5. Enter Delinquent Return Amount, Item 414, Form 5599. 6. Close tax case to the EO Closing Unit.
8.	You issue a new 30-day Letter 950 (or Letter 3614) & report to correct the tax return, but the organization then replies with additional information showing the correction was unnecessary	<p>The Matter of Processing the Converted Tax Return:</p> <ol style="list-style-type: none"> 1. Follow delinquent return procedures. 2. Submit return to the FAST after the adverse status change posts to the EOBF. <p>The Matter of Your Adjustment to the Tax Return:</p> <ol style="list-style-type: none"> 1. Issue Letter 5332. 2. Prepare Form 5599 for converted tax return, DC 06 (208). 3. Enter ARDI Code, Item 42, Form 5599. 4. Enter Items 35 and 37, Form 5599. 5. Enter Delinquent Return Amount, Item 414, Form 5599. 6. Close tax case to the EO Closing Unit.
9.	You issue a new 30-day Letter 950 (or Letter 3614) & report to correct the tax return, and the organization agrees with your correction.	<p>The Matter of Processing the Converted Tax Return:</p> <ol style="list-style-type: none"> 1. Follow delinquent return procedures for converted tax return. 2. Submit return to the FAST after the adverse status change posts to the EOBF. <p>The Matter of Your Adjustment to the Tax Return:</p> <ol style="list-style-type: none"> 1. Stamp the received date on Form 4549 (or Form 870-E). 2. Issue Letter 3607. 3. Prepare Form 5599 for converted tax return, DC 03 (102). 4. Enter ARDI Code, Item 42, Form 5599. 5. Close tax case to the EO Closing Unit.

10.	You issue a new 30-day Letter 950 (or Letter 3614) & report to correct the tax return, and the organization fails to reply.	<p>The Matter of Processing the Converted Tax Return:</p> <ol style="list-style-type: none"> 1. Follow delinquent return procedures for converted tax return. 2. Submit return to the FAST after the adverse status change posts to EOBF. <p>The Matter of Your Adjustment to the Tax Return:</p> <ol style="list-style-type: none"> 1. Prepare Form 5599 for converted tax return, DC 10 (604). 2. Close tax case to Mandatory Review to issue the SNOD.
11.	You issue a new 30-day Letter 950 (or Letter 3614) & report to correct the tax return, and the organization disagrees with protest	<p>The Matter of Processing the Converted Tax Return:</p> <ol style="list-style-type: none"> 1. Follow delinquent return procedures for the converted tax return. 2. Submit the return to the FAST after the adverse status change posts to the EOBF. <p>The Matter of Your Adjustment to the Tax Return:</p> <ol style="list-style-type: none"> 1. Issue Letter 5326 rebuttal to organization. 2. Prepare Form 5599 for converted tax return, DC 07 (601). 3. Close tax case to Mandatory Review to send to Appeals.

(9) If the underlying adverse status change is **not** sustained by Mandatory Review or Appeals:

- Mandatory review will also send the NMF SFCR converted tax return case file back to you for deletion.
- Mandatory Review will destroy Form 2363-A and Form 5666 (located in the primary return case file).
- Delete the NMF examination account. Follow deletion instructions in IRM 4.75.16.3.1, Deleting AIMS Accounts.

- (10) With respect to an SFR Form 990-PF converted tax return in subparagraph (6)e, the adjustment need not be limited to IRC 4940 tax, which **is** subject to deficiency procedures. You can also adjust non-tax items, such as the reported distributable amount, qualifying distributions, or undistributed income. If adjusting non-tax items is the only adjustment in the SFR, the adjustment is subject to a nonstandard 30-day letter, with protest to Appeals, but **not** subject to issuance of a final 90-day letter by Mandatory Review. Consult with **TEGE EO Review Staff* on a nonstandard 30-day letter. Any IRC 4942 tax resulting from non-tax adjustments is itself reported separately on Form 4720, which **is** subject to full deficiency procedures.

4.75 Exempt Organizations Examination Procedures

4.75.31.4.1 (07-17-2017) Form 3198-A - SFCR Case File

- (1) Prepare Form 3198-A for every SFCR case file. Enter one or more of the following notations if applicable in "Other Instructions" or under the "Mandatory Review" check box before closing the case to either Mandatory Review or the EO Closing Unit:
 - Check the box for "Send All Communications Per POA."
 - Check the box for "Mandatory Review" box and enter "Unagreed Income Tax Deficiency."
 - Check the box for "Forward to Appeals."
 - At Special Features: Indicate "Place Converted Tax Return Case In Mandatory Review Suspense (Status 38) Pending Outcome of Revocation [Disqualification or Reclassification to PF]."
 - Check the box "SFR - Substitute for Return to be Processed."
 - Indicate "Assess Tax Per Form 4549 [Form 4883] – Exempt Status Revoked [Disqualified] or [IRC 501(c)(3) Reclassified as a PF]."
 - At the "Earliest Statute Date" section, "The Statute Starts With Filing of Form 990 [990-EZ, 990-PF, 990-BL] on [Date] and Expires [ASED]."
 - Check the box for "Forward to Appeals."
 - Transfer Payments Applied to 990-T Module for the Revoked [Disqualified] Tax Years to the Converted 1120 [1041] Module - Then Reverse Tax Assessments on 990-T Tax Module.
- (2) Place this Form 3198-A on the outside cover of the SFCR case file folder on top of Form 5599.

Note: Refer to IRM 4.75.31.2.5 for instructions on Form 3198-A for the primary return case file.

Note: Refer to IRM 4.75.31.3.2 for instructions on Form 3198-A for the secured converted tax return to be adjusted case file.

4.75.31.5 (07-17-2017) EO Enforcement Criteria

- (1) Generally, EO examiners must enforce converted return taxes for the affected

#

Note: "Enforcement" is part of the conversion process that involves initiating deficiency procedures in IRM 4.75.31.3 and IRM 4.75.31.4.

Note: Mandatory Review will accept business decisions made over enforcement so long as they are properly supported and documented.

- (2) EO Enforcement is NOT required under any one of the following conditions:

#

aggregate.

- The time remaining on the ASED based on the filing of Form 990 or 990-EZ is less than 12 months. See IRM 4.75.10.6.1(3).
- There is an NOL available to offset taxable income for the year under consideration.
- The organization is inactive, non-operational or abandoned.
- The converted return tax is reportable on specialized tax returns, e.g., Form 1120-L, Form 1120-F, etc.
- The converted return tax issues require specialized examiners trained to address the complex issues.

- An income tax BOD is interested in working the converted return tax case.
- Sufficient resources are unavailable, considering Policy Statement 4-119.

(3) Additional factors to consider in enforcing converted return taxes include:

- That failure to enforce converted return taxes could be a serious administrative omission or result in a serious criticism of the IRS's administration of tax law with fairness and integrity.
- The relative simplicity of the income tax issues and the conversion
- The need to quickly process a deficiency.
- History, extent or frequency of repeated or continuous noncompliance
- Indicators of fraud, malfeasance, collusion, concealment, or misrepresentation.
- Your familiarity with the case versus the time needed for another group to re-learn the case.
- Setting a precedent that could seriously hamper the IRS's subsequent attempts to take corrective action.
- The effect on future noncompliance by like organizations in the same industry or profession.
- The negative impact on EO Examinations programs, goals, work plans, implementing guidelines and strategic plan.
- The technical complexity of the income tax issues and the excessive demands on time for issue resolution.
- The availability of trained examiners and expertise in the specific income tax matter.
- Sensitivity of the case that should be addressed by SB/SE.
- Avoiding inconsistent treatment of similarly situated organizations in a market segment worked.
- Collectibility

(4) If you can't enforce the converted return taxes, prepare Form 5666 (or Form 5346) package. Indicate the reason for not pursuing income tax on Form 3198-A for the EO information return case file.

4.75.31.6
(07-17-2017)
**Scope of EO
Enforcement**

- (1) Policy Statement 4-119 states that the primary objective of the EO examination program is regulatory, with emphasis on the continued qualification of exempt organizations. For purposes of applying limited resources, income tax enforcement of revoked or disqualified organizations is incidental to that primary objective. The referral option on Form 5666 is available.
- (2) Policy Statement 4-63 provides that deficiencies should be based on meritorious adjustments. No adjustments should be included for punitive, bargaining, or similar purposes. Estimated amounts to protect the Government's interest may be used only when it is impossible to establish exact amounts.
- (3) In recognition of existing EO work plans and implementing guidelines, EO examiners will generally enforce income taxes by rolling over amounts known to be correct on the primary return, to the RAR of the tax return. See the Conversion Table at Exhibit 4.75.31-7.
- (4) Converted return taxes are generally enforced for a maximum of 6 years. See P-5-133 at IRM 1.2.14.1.18 (8/2007).

4.75 Exempt Organizations Examination Procedures

- (5) In appropriate cases, consult with Area Counsel to determine whether special statute conditions exist for any return or tax year, e.g., 6-year statute. Area Counsel requires 45 days to provide a written opinion. See IRM 4.75.16.4.2.1(3) for statute considerations.

4.75.31.7
(07-17-2017)

Determination of Tax Liability

- (1) Examiners may rely on the following resources to help determine income taxes.
- GCM 39813.
 - 1990 CPE Text, Topic B, The Synanon Case.
 - CCH U.S. Master Tax Guide.
 - IRM Chapters 4.10, 4.11 and 4.12.
 - Income tax training textbooks.
 - Training Pub 11361-002, LMSB Corporate Taxation Participant Guide (Catalog 50286Q).
 - Consult with fellow examiners with strong income tax background.
 - Lexis-Nexis® and Westlaw®.
 - SB/SE or LB&I websites. See *SB/SE's Issues and Procedures* website.

4.75.31.7.1
(02-07-2012)

Basic Income Tax Considerations

- (1) Apply IRC 7701. Identify the entity's legal status as a corporation, association, trust, cooperative or partnership. This determines what type of return needs to be filed. Unincorporated associations are generally treated as corporations liable for Form 1120 returns.
- (2) Don't make income tax elections on behalf of taxpayers.
- (3) All income is taxable and included in gross income unless excluded by statute. IRC 61.
- (4) Regarding certain dues collected for others, escrow funds, similar trust funds, and amounts received on behalf of others, such amounts are not included in the organization's gross income until the organization asserts dominion over it as its own. See guidance on an income determination with respect to deposits in *Commissioner v. Indianapolis Power & Light Co.*, 110 S. Ct. 589; See Rev. Rul. 71-189, 1971-1 C.B. 32 (inactive deposits are not income until bank asserts dominion over the accounts). See also *Fidelity-Philadelphia Trust Co. v. Commissioner*, 23 T. C. 527 (1954).
- (5) Contributions and donations received may or may not be taxable. See IRC 102.
- Determine whether a contribution received constitutes a "gift".
 - Gifts are excluded from gross income by IRC 102 of the Code.
 - "Intent" is a critical consideration in determining whether a transaction is a gift. *Commissioner v. Duberstein*, 363 U.S. 278 (1960).
 - However, if the gift is acquired by misrepresentation or fraud it is included in gross income of the recipient. *Synanon Church v. Commissioner*, T.C. Memo. 1989-270.
 - Government grants are not automatically presumed to be gifts. In some cases, a governmental entity can expect an economic benefit from programs that relieve business or individual hardships. For guidance, refer to *Kroon v. United States*, Civil No. A-90-71 (D. Alaska 1974); Rev. Rul. 77-280, 1977-2 C.B. 14; Rev. Rul. 68-97, 1968-1 C.B. 34; and *United States v. Chicago, B. & Q. R. Co.*, 412 U.S. 401 (1973), 1973-2 C.B. 428.

- f. Quid pro quo contributions are gifts only to the extent the total amount received exceeds the fair market value of the consideration provided to the donor. IRC 6115(b).

(6) Deductibility of Expenses.

- a. Apply the rules of IRC 162. Expenses are deductible only to the extent they are ordinary and necessary in carrying on a trade or business.
- b. The income-offset rule allows full deduction for exempt function expenses but only to the extent of income derived from the exempt function. See *Adirondack League Club*, 55 T.C. at 806; *Five Lakes Outing Club v. U.S.*, 468 F. 2d 443, 446 (8th Cir. 1972); *Synanon*, 57 T.C.M. at 631.
- c. Similarly, charitable distributions are deductible in full only to the extent of the charitable gifts received. For corporations, charitable distributions from other income are deductible only to the extent of 10% of taxable income after certain adjustments. See limitations at IRC 170(b)(2).

Note: Some organizations may want to claim charitable and program expenses as “promotional expenses”, which if proven to be ordinary and necessary, are fully deductible.

- d. Lobbying and political expenses are not deductible expenses.
- e. Fines and penalties are not deductible expenses.
- f. Amounts paid for kickbacks, bribes, and other illegal payments are not deductible expenses.
- g. Amounts paid by health care providers for payments in consideration of the referral of a client, patient or customer are not deductible expenses.
- h. Amounts in excess of reasonable compensation or compensation for non-profit motivated activities are not allowable as a deduction.
- i. Income taxes paid (including UBIT) are not deductible.
- j. Expenses incurred in connection with a convention, seminar, or similar meeting held outside the “North American area” are limited under IRC section 274(h). Rev. Rul. 2011-26, 2011-48 I.R.B. 803.

(7) Substantiation of Expenses.

- a. Generally the burden of proving the existence of a deduction or loss falls on the organization.
- b. Examiners should use their best judgment in balancing utilization of time on substantiating expenses and accomplishment of the overall EO examination program as directed by Management. Thus, EO Examiners are not required to substantiate all deductible expenses unless the situation demands it.
- c. Scrutiny should be reserved for expenses that appear unreasonable, large, unusual, and questionable. *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84 (1992) [92-1 USTC P 50,113].
- d. The “Cohan rule” is often cited by taxpayers who ask to use estimates where specific proof of the amount of the claimed deduction is absent. *Cohan v. Commissioner*, 39 F. 2d 540, 543-544 (2d Cir. 1930) [2 USTC P 489]. However, the organization must establish the essential proof necessary to allow for an estimate. *Coloman v. Commissioner*, 540 F. 2d 427 (9th Cir. 1976) [76-2 USTC P 9581], affirming T. C. Memo. 1974-78; see also *Vanicek v. Commissioner*, 85 T.C. 731 (1985).
- e. Expenses for travel, entertainment expenses, business gifts, computers and vehicles require record-keeping before a deduction is allowed. These

4.75 Exempt Organizations Examination Procedures

expenses should be substantiated in accordance with IRC 274(d) and IRC 280F and the regulations thereunder.

(8) Depreciation.

- a. A depreciable asset begins to depreciate in the year it is first placed in service.
- b. Note that the useful life or cost recovery period for certain assets may have expired before the year under examination began; thus, further depreciation of such assets would not be allowed.
- c. Certain assets are NOT depreciable, such as certain works of art and land.
- d. The IRC 179 deduction is only allowed if an election was made on a voluntarily filed tax return.
- e. In general, the depreciation method depends on when tangible property was placed in service:
 1. Since 1986 – Generally Use MACRS,
 2. After 1980, but before 1987 – Use ACRS,
 3. Before 1981 – Use straight line, DB, SYD or other consistent method.
- f. EO examiners generally will not challenge the organization's depreciation methods established before the revoked years, and reported on annual EO Information Returns.

(9) Dividend Received Deduction.

- a. Corporations are allowed a special deduction called a dividend received deduction. See IRC 243, IRC 244, IRC 245 and IRC 246. The major reason for the dividend received deduction in IRC 243 is to avoid so-called "double taxation" in corporate taxes on earnings as income is passed from one corporation to another.
- b. Generally examiners will not allow this deduction unless a revoked organization can establish that it is entitled to the deduction.

(10) IRC 277, Deductions Incurred by Certain Membership Organizations in Transactions with Members.

- a. IRC 277 provides that a membership organization not exempt from tax may deduct expenses attributable to the provision of goods or services to members only to the extent of income derived from members. The purpose of this provision is to prevent nonexempt membership organizations from effectively rendering themselves free of tax by off-setting losses from membership activities against income derived from investments or other nonmember sources to produce little or no taxable income. Were they permitted to do so, they could put themselves in a better position than exempt clubs, which are taxable on all income but "exempt function" income.

(11) Other Income tax provisions.

- a. IRC 263 and IRC 263A requires corporations to capitalize certain expenditures, or include in inventory certain costs incurred in connection with real property and inventory.

- b. IRC 470 provides that if a corporation leases property to a governmental or other tax-exempt entity, the corporation cannot claim deductions related to the property to the extent that they exceed the corporation's income from the lease payments.
- c. If an organization under examination requests a change in accounting method, follow the procedures in IRM 4.11.6. A request for change in accounting method for an organization under examination requires the consent of the Director, EO Examinations before an application on Form 3115, *Application for Change in Accounting Method*, can be submitted in accordance with the instructions of the form. See Rev. Proc. 2008-52, 2008-2 C.B. 587.

4.75.31.7.2
(02-07-2012)

Gift Tax Consequences

- (1) IRC 2501 imposes a gift tax on donors who give to taxable entities, knowing it's a taxable entity or after public notice of the revocation. A donor is not subject to gift tax and has advance assurance of charitable deductibility under IRC 170 for amounts contributed to a revoked IRC 501(c)(3) entity prior to public notice of the revocation (such as in the Internal Revenue Bulletin, however, notice may occur in other ways, see *Estate of Clopton v. Commissioner*, 93 T.C. No. 275 (8-29-89)).
- (2) Consult with Gift Tax Specialist (attorney). Enforcement of this tax requires a referral to Estate and Gift using SRS online.

4.75.31.7.3
(02-07-2012)

Effect on Employee Plans

- (1) The revocation of an organization's IRC 501(c)(3) status may adversely impact deferred compensation programs sponsored by the organization. Consult with an Employee Plans IRC 403(b) or IRC 457 Coordinator for your area if the organization maintains a deferred compensation plan. Deferred compensation plans are those described under IRC 401(a), IRC 403(b) or IRC 457.

4.75.31.7.4
(02-07-2012)

Effect on Tax Exempt Bonds

- (1) Revocation of an organization's IRC 501(c)(3) status will result in the loss of the exclusion from gross income under IRC 103 for interest payments on tax-exempt obligations issued under IRC 145 as "qualified 501(c)(3) bonds." The loss of such exclusion is effective back to the date of issuance of the IRC 501(c)(3) obligations.
- (2) Determine whether the organization is the beneficiary of outstanding tax-exempt obligations under IRC 145 at the time of revocation.

4.75.31.7.4.1
(07-17-2017)

Referral to Tax Exempt Bonds (TEB)

- (1) Because a revocation of the tax-exempt status of an IRC 501(c)(3) organization results in the loss of excluding interest from gross income of bondholders on the organization's qualified IRC 501(c)(3) bonds a referral is required to Tax Exempt Bonds. This section describes the procedure to make a referral by transmitting the required information to the TEB Referral Coordinator.
- (2) Use the *Specialist Referral System (SRS)* or Form 5666 to refer a potential noncompliant bond issuance to the TEB Referral Coordinator. Detailed instructions for completing the form are located in IRM Exhibit 4.5.1-12.
- (3) Complete a separate Form 5666 with all information that is available about the issuer of the bonds and the nature and size of the potential noncompliance issue. Include information pertaining to the source of the EO examination and attach any news articles, correspondence or other documentation concerning the potential noncompliance issue with the Form 5666. The referral package

4.75 Exempt Organizations Examination Procedures

should be as complete as possible with objective information to facilitate the TEB Classifiers in making their recommendations of compliance actions.

- (4) Use the proper AIMS Source Codes for each referral. The following guidance will assist the originator in determining the proper source code for referrals and the preparation of Form 5666 or the Specialist Referral System.

- a. Use the appropriate source codes based on the EO examination. TEB source codes are identified in the GE Computer Systems Codes Book, Document 11308.

4.75.31.8
(07-17-2017)

Statute Protection - Dual Responsibility With Appeals

- (1) Both the primary return (e.g., Form 990) and the converted tax return (e.g., Form 1120) for the same tax year will share the same statute date based on the filing of the same Form 990. However, the two MFT case files will be separated once Mandatory Review ships the primary return case to Appeals assuming the organization protests the proposed adverse status change. This results in separating case assignments, and therefore dual responsibility for monitoring statutes.
- (2) At the onset, you are primarily responsible for monitoring and protecting the statute on all returns you establish on AIMS, including converted tax returns.
 - a. However, if an organization protests an adverse status change (e.g., Form 990 returns) for specific tax years, Appeals will assume primary responsibility for protecting the statute of limitations for those tax years once accepted in their inventory.
 - b. You will continue to monitor statutes for **all** converted return tax years you establish on AIMS, but because Appeals assumed *primary* responsibility for protecting the statute for the protested years, you continue to assume *primary* responsibility for protecting the statute of limitations for the **non**-protested years, if any.
- (3) While the primary returns (e.g., Form 990) are in Appeals for resolution of the exemption issue, Mandatory review will hold the converted tax return case file in Status 38 suspense:
 - a. Mandatory Review will only hold the converted tax return case file in Status 38 suspense until the sooner of:
 1. A converted tax return in the case file becomes a "short statute return," requiring "statute controls" or
 2. Appeals has decided the adverse status change issue.
 - b. If a converted tax return becomes a short statute return, the reviewer will send the converted tax return case file back to you to monitor statutes for **all** converted return tax years, and to protect and solicit a statute extension for the non-protested tax years, if any.
 - c. If the organization will not consent to extend the statute date for any short statute returns, you and your manager may take steps to initiate deficiency procedures in order to protect the tax, even if the adverse status change is not yet resolved in Appeals.
 - d. Consult with Area Counsel regarding your issuance of a statutory notice of deficiency for a converted tax return if the ASER is imminent.
 - e. **Don't** suspend the converted tax return case file using AIMS Status Code 39. See IRM 4.75.16.4.2.1.1 for statute extension procedures.

- (4) You are allowed to contact Appeals if needed to coordinate communications with the organization and soliciting statute extensions. This communication will not violate Rev. Proc. 2012-18, 2012-10 I.R.B. 455, regarding ex parte communications because it meets the ministerial, administrative or procedural matters exception in Section 2.03(2)(a) of the Rev. Proc, so long as the issues are not discussed.
- (5) The instructions in the previous paragraphs are illustrated by the following examples:

Example: (1) By reason of IRC 6501(g)(2), Form 990 and 1120 show the same statute expiration date. Due to a proposed revocation of tax-exempt status under protest, Appeals has one set of returns under its control - 2014 and 2015 Forms 990; the examination group has another set of returns under its control - 2014 and 2015 converted Forms 1120 (on AIMS NMF). The statute expires in less than 270 days for both 2014 and 2015 returns and the examination group wants to solicit statute extensions from the organization. Appeals has primary responsibility for protecting the statute of limitations for income taxes for 2014 and 2015. In this case, the examination group may initiate contact with Appeals to follow-up on whether Appeals solicited and secured statute extensions for income tax for 2014 and 2015. Because the communication is restricted to coordinating the solicitation and securing of statute extensions, this is a permissible procedural communication that falls within the ministerial, administrative or procedural matters exception and is permissible so long as the substance of issues is not discussed. See section 2.03(2)(a) of Rev. Proc. 2012-18.

Example: (2) Assume the same facts as Example (1) but in addition, the organization refuses to extend the statute of limitations after both the examiner and Appeals coordinated their solicitations to extend the statute for their respective short statute returns. The statute expiration date is within 90 days and the revocation matter is not yet settled. The examination group wants to issue an SNOD for income tax. The examination group can inform Appeals of its plan to issue an SNOD because the communication is restricted to the prospect, method and timing of issuing a SNOD. Protecting the government's interest for separate returns sharing the same statute date is a procedural matter. The communication is permissible so long as the substance of issues and the contents of the SNOD are not discussed. See section 2.03(2)(a) of Rev. Proc. 2012-18.

Example: (3) examiner T is examining XYZ's 2014 Form 990. XYZ is exempt under IRC 501(c)(3). T determines XYZ's exempt status should be revoked effective 1/1/2014. Based on T's examination of the 2014 books and records, T estimated XYZ's income tax liability for 2014 to be \$6,000. After inspecting the 2015 Form 990 return alone, T also estimates the income tax liability for 2015 to be \$8,000. To protect the income tax for both tax years, T establishes the 2014 and 2015 Form 1120 SFR on AIMS Non-Master File for later adjustment pending the final outcome of your proposed revocation. XYZ appeals T's proposed revocation. T closes the Form 990 case file to Mandatory Review, with the Form 1120 case file riding with the package. Mandatory Review later forwards the Form 990 case file to Appeals. Two months later, both the 2014 Form 990 and the 2014 SFR Form 1120 become short statute

4.75 Exempt Organizations Examination Procedures

returns. Because Appeals has primary responsibility for protecting the statute for income tax in 2014, T may initiate contact with Appeals to follow-up on their request to extend the statute of limitations for income tax for 2014 without violating ex parte rules.

Example: (4) Assume the same facts as Example (3) except both the 2014 and 2015 Form 1120 returns are short statute returns. Because Appeals continues to have primary responsibility for protecting the statute for income tax in 2014, T may initiate contact with Appeals to follow-up on their solicitations to extend the statute of limitations for the 2014 income tax. While Appeals doesn't have a 2015 Form 990 return in its inventory, T is primarily responsible for protecting the statute of limitations for the 2015 income tax.

Example: (5) Assume in Example (4) that Appeals has issued a 90-day final adverse determination letter (FADL) notifying XYZ of the final revocation of its exempt status. Because Appeals is closing its case, Appeals is no longer primarily responsible for protecting the statute of limitations for the 2014 income tax. T now assumes primary responsibility for protecting the statutes for both the 2014 and 2015 income tax while Form 1120 SFR returns in T's inventory. Appeals' issuance of a FADL does **not** suspend the statute of limitations for any tax year. Only Mandatory Review's or T's issuance of a 90-day SNOD will suspend the statute of limitations for assessment if the taxpayer won't extend the statute.

- (6) If the organization refuses to extend the ASER for short statute converted tax returns, discuss your next course of action with your manager. Generally, you will prepare the tax case for closure to Mandatory Review for issuance of a SNOD in order to protect the government's interest, even if the revocation issue is undecided in Appeals.

Note: While the adverse status change issue is working in Appeals, the converted return tax case will still be on NMF. You must process that closure on NMF unless and until the revocation is sustained and posted to the EOBMF.

- (7) If the statute is imminent you must issue the SNOD. See IRM 4.75.16.4.2.4 for approval procedures. See IRM 4.75.20 for SNOD preparation procedures. Upon issuance of the SNOD, close the income tax case to Mandatory Review for 90-day suspense (AIMS Status 24) within 5 business days.
- (8) Appeals will notify EO Examinations if the organization has no intention to execute a consent to extend the statute date by the earlier of:
- 120 days prior to the statute expiration date.
 - The date Appeals sends its case to Counsel for review of the 90-day FADL.
- (9) Appeals will also inform EO Examinations:
- If and when the adverse status change was approved by Counsel, and
 - When it issues a 90-day FADL.

4.75.31.9
(07-17-2017)
**Revocations and
Disqualifications -
Alternative Positions**

- (1) The UBIT issue for the open Form 990-T examination for the affected tax years should be fully developed before closing the adverse status change case (primary return)

Note: The presence of a Form 990-T examination only impacts what goes on the proposed revocation or disqualification RAR and on Form 3198-A for the primary return case file. It has no effect on conversion procedures.

- (2) Incorporate the UBIT issue as an alternate position in the revocation or disqualification report. See IRM 4.75.15.7.1.7. Include Form 990-T at the heading of Letter 3618.
- a. If there is no change to UBIT under examination, include a statement to that effect after the conclusion part of the revocation or disqualification RAR.
 - b. If there is a UBIT deficiency, include the deficiency as your alternative position after the conclusion part of the revocation or disqualification RAR, complete with facts, law and argument and Form 4549 marked "Alternative Position" in the top margin.

Exception: If you requested a TAM on a revocation issue that grants IRC 7805(b) relief to the organization, process the Form 990-T case file for a normal *tax-exempt* organization for years of examination, because the revocation will be prospective.

Note: In cases where there is a revocation or disqualification report with an alternate UBIT issue, include a *copy* of the proposed revocation or disqualification report in the Form 990-T case file.

- (3) If applicable, notate the following on Forms 3198-A for the primary return case file and for the Form 990-T case file if also open for examination: *"If Revocation [Disqualification] is Sustained, Transfer Payments Applied to 990-T Module for the Revoked [Disqualified] Tax Years to the Converted 1120 [1041 or 990-PF] Module - Then Reverse Tax Assessments on 990-T Tax Module."*
- (4) Close Forms 990-T for the affected tax years with identical revocation or disqualification disposal codes used for the primary returns, unless a higher priority disposal code applies.

Exception: If you requested a TAM on a revocation issue that grants IRC 7805(b) relief to the organization, use disposal codes for Form 990-T for a normal tax-exempt organization, because the revocation will be prospective.

This Page Intentionally Left Blank

Exhibit 4.75.31-1 (06-17-2010)**Form 2363-A – Revocation of IRC 501(c)(3) and Generating 1120 Filing Requirement**

Revocation of IRC 501(c)(3) - Instructions For Form 2363-A	
Field 1	Enter the EIN.
Field 2	Enter the name control.
Field 3	Place an X in the box next to 80.
Field 4	Place an X in the box next to 016.
Field 5	Type in definer codes A and B.
Field 8	Type in the name of the entity.
Field 17	Enter 03.
Field 18	Type in the two digit foundation status code. See BMFOLO or INOLES.
Field 19	Type in the one digit classification code. See BMFOLO or INOLES.
Field 22	Type in 22 followed by the year and month of effective revocation date.
Field 34	Type in the number 9 to remove Employment Code "W".
Field 35	Type in the two digits representing the ending month of the fiscal year.
Field 38	Place an 01 in the 941 field and an 01 in the 940 field (if applicable.)
Field 39	Type REVOKE C-3 AND SET 941 -940 AND 1120 FILING REQ.
Field 40	Digitally sign and date or print the form, sign and date it.
Field 41	Type in PREPARER/GROUP NUMBER.

Exhibit 4.75.31-2 (06-17-2010)**Form 2363-A – Revocation of PF and Generating Form 1120 Filing Requirement**

Revocation of IRC 501(c)(3) (PF)- Instructions For Form 2363-A	
Field 1	Enter the EIN.
Field 2	Enter the name control.
Field 3	Place an X in the box next to 80.
Field 4	Place an X in the box next to 016.
Field 5	Type in definer codes A and B.
Field 8	Type in the name of the entity.
Field 17	Enter 03.
Field 18	Type in the two digit foundation status code. See BMFOLO or INOLES.
Field 19	Type in the one digit classification code. See BMFOLO or INOLES.
Field 22	Type in 19 followed by the year and month of effective revocation date.
Field 34	Type in the number 9 to include Form 940 as a filing requirement.
Field 35	Type in the two digits representing the ending month of the fiscal year.
Field 38	Place an 01 in the 941 field and an 01 in the 940 field (if applicable.)
Field 39	Type REVOKE C-3 AND SET 941 -940 AND 1120 FILING REQ.
Field 40	Digitally sign and date or print the form, sign and date it.
Field 41	Type in PREPARER/GROUP NUMBER.

Revocation of IRC 501(c)(3)(PF)- Instructions For Form 2363-A	
Field 1	Enter the EIN.
Field 2	Enter the name control.
Field 3	Place an X in the box next to 80.
Field 4	Place an X in the box next to 016.
Field 5	Type in definer codes A and B.
Field 8	Type in the name of the entity.
Field 17	Enter 03.
Field 18	Type in the two digit foundation status code. See BMFOLO or INOLES.
Field 19	Type in the one digit classification code. See BMFOLO or INOLES.
Field 22	Type in 19 followed by the year and month of effective revocation date.
Field 34	Type in the number 9 to include Form 940 as a filing requirement.
Field 35	Type in the two digits representing the ending month of the fiscal year.

Exhibit 4.75.31-2 (Cont. 1) (06-17-2010)**Form 2363-A – Revocation of PF and Generating Form 1120 Filing Requirement**

Field 38	Place an 01 in the 941 field and an 01 in the 940 field (if applicable.)
Field 39	Type REVOKE C-3 AND SET 941 -940 AND 1120 FILING REQ.
Field 40	Digitally sign and date or print the form, sign and date it.
Field 41	Type in PREPARER/GROUP NUMBER.

Exhibit 4.75.31-3 (06-17-2010)**Form 2363-A – Revocation of IRC 501(c)(3)(Other) and Generating Form 1120 Filing Requirement**

Revocation of IRC 501(c)(3)(Other)- Instructions For Form 2363-A	
Field 1	Enter the EIN.
Field 2	Enter the name control.
Field 3	Place an X in the box next to 80.
Field 4	Place an X in the box next to 016.
Field 5	Type in definer codes A and B.
Field 8	Type in the name of the entity.
Field 17	Enter code section. i.e., 04,05, etc.
Field 18	Type in the two digit foundation status code. See BMFOLO or INOLES.
Field 19	Type in the one digit classification code. See BMFOLO or INOLES.
Field 22	Type in 22 followed by the year and month of effective revocation date.
Field 34	Type in the number 9 to include Form 940 as a filing requirement.
Field 35	Type in the two digits representing the ending month of the fiscal year.
Field 38	Place an 01 in the 941 field and an 01 in the 940 field (if applicable.)
Field 39	Type REVOKE C-3 AND SET 941-940 AND 1120 FILING REQ.
Field 40	Digitally sign and date or print the form, sign and date it.
Field 41	Type in PREPARER/GROUP NUMBER.

Exhibit 4.75.31-4 (07-17-2017)**Summary Instructions for Form 4549 for the Converted Return**Substitute for Return - Form 4549

Taxable income and expense items will be treated as adjustments on line 1

Line 1, Lists adjustments. Adjustments should be supported by computations and explanations on attached schedules or worksheets.

Line 2, is the sum of all "adjustments".

Line 3, *Taxable Income Per Return or as Previously Adjusted.*

If a tax return was filed and an adjustment to that return is proposed: This amount will be taxable income shown on the tax return after it posted. If the tax return has posted, refer to this amount as stated in BMFOLR.

Substitute Return. This amount will always be zero because no taxable income had been previously reported on Form 1120 series or Form 1041. This is true even if Form 990-T was filed for the tax year while the organization was exempt.

Line 12, *Total Tax Shown on Return or as Previously Adjusted.*

If a tax return was filed and an adjustment to that return is proposed: This amount will be the total tax shown on the tax return. If the tax return has posted, refer to this amount as stated on BMFOLT.

Substitute Return. This amount will always be zero because no income tax had been previously reported on Form 1120 or Form 1041. This is true even if Form 990-T was filed for the tax year reporting income tax while the organization was exempt.

Other Information, Explain the amount of unrelated business income tax already paid for the tax years the organization was exempt, including payments for penalties and interest. Be sure to explain the circumstances giving rise for the need to transfer payment credits against any UBIT for affected tax years to the Form 1120 or Form 1041 module. In Other Instructions of Form 3198-A for the tax return, indicate "REVERSE TAX ASSESSMENTS ON 990-T TAX MODULE AND TRANSFER PAYMENTS FOR UBIT TAXES TO CONVERTED RETURN MODULE IF REVOCATION IS SUSTAINED." Do not include amounts paid for UBIT taxes as a credit in the dollar columns of Form 4549.

Examiners should not interpret the agreement to tax as an agreement to revocation.

Exhibit 4.75.31-5 (10-18-2019)**AIMS Master File Establishments of Converted Tax Returns**

You establish a converted tax return on AIMS MF only after the underlying proposed adverse status change is sustained and posted. You can proceed to submit a 30-day letter and RAR to the organization, and solicit an agreement to a tax deficiency.

If an AIMS NMF examination record was previously established for the same returns, you must delete the duplicate NMF examination record after fully establishing the AIMS MF examination record. See IRM 4.75.16.3.1, Deleting AIMS Accounts.

Establish an examination record on AIMS Master File using RCCMS. If you must establish the examination record manually using Form 5597, follow the instructions below.

The items in parenthesis denote corresponding block numbers on Form 5597.

- (P7-8): Source Code 44 for SFCRs.
- (P10-12): Enter Primary Business Code.
 - 401 Northeast.
 - 403 Great Lakes/FIU.
 - 404 Gulf Coast.
 - 406 Pacific Coast.
 - 410 EOCA.
- (P20-23): Enter Employee Group Code.
- (P25-26): Enter MFT 02 for Form 1120; MFT 05, For Form 1041, MFT 44 for Form 990-PF.
- (P28-29): Enter Status Code 12.
- (P31): Return Not Requested should be "3".
- (P33-36): Enter appropriate Project Code.
- (P41-43): Enter Push Code 036, for a SFCR establishment; 020 for a secured delinquent return.
- (P45-46): Enter Statute Alpha Code, if appropriate.
- (P48): Enter "1" as the flow-through indicator.
- (Line 2, P1-12; P14-17; blocks A and B): Enter Entity information.
- (P19-24): Enter Tax Periods.
- (P26-28): Enter Activity Codes:
 - Form 1120 Activity Codes are 338, 203 through 231;
 - Form 1041 Activity Codes are 495 or 496.
- (Blocks C, D and E): Self Explanatory.

Note: See also IRM 4.5.1, Leave the SBC field blank for manual establishments on Form 5597. You can enter the SBC for AIMS MF establishments made on RCCMS. See IRM Exhibit 4.5.1-8 and IRM Exhibit 4.5.1-10.

Exhibit 4.75.31-6 (07-17-2017)**AIMS NMF Establishments of Converted Tax Returns**

You establish a converted tax return on NMF because you recognize the need to protect the converted tax, but your underlying proposed adverse status change is not yet final and posted. While the adverse status change is not final, generally don't submit a 30-day letter and RAR to the organization, and don't solicit an agreement to a tax adjustment until you know the adverse status change is sustained by Mandatory Review (or Appeals if protested).

Establishing Form 1120 on NMF Pending Finality of Adverse Status Change

- Validate For: Establish.
- Update AIMS: Unchecked.
- Type: Form 1120.
- Activity Codes: 338, 203 through 231 [For Form 1041, 495 or 496].
- Statute date: The statute date is assumed to be the same as the statute date for the EO information return. If the organization is a non-filer, it is the date the tax return will be postmarked or filed with the examiner.
- Master File type: NMF – Non-Master File.
- MFT Code: 32 (Form 1120 NMF), or 21 (Form 1041 NMF).
- Source Code: 44.
- Status Code: 10.
- Reason for Request: Protective AIMS establishment for Conversion of Form 990 to Form 1120 ; Case suspended while revocation is unagreed.
- Save and Close.
- Select Request Establishment from the Actions menu.

Note: The activity will be established on RCCMS without the AIMS box checked. The AIMS NMF establishment must be done manually on Form 5588. See instructions for Form 5588 at IRM Exhibit 4.5.1-11 and Exhibit 4.5.1-12. Leave the SBC field blank for manual establishments on Form 5588. See IRM Exhibit 4.5.1-8 and IRM Exhibit 4.5.1-10.

Exhibit 4.75.31-7 (07-17-2017)**Form 990 to Form 1120 Conversion Table**

<i>Contributions, gifts, grants, and other receipts</i>	
Form 990 Description	Form 1120 Description
Direct public support	Non-taxable or Gross Receipts or Sales 1 & 2
Indirect public support	Non-taxable or Gross Receipts or Sales
Government contributions	Gross Receipts or Sales 3
Program service revenue including government fees and contracts	Gross Receipts or Sales
Membership dues and assessments	Gross Receipts or Sales 4
Interest on savings and temporary cash investments	Interest
Dividends and interest from securities	Dividends
Gross rents	Gross Rents 5
Less: rental expenses	Other Deductions 5
Other investment income	Other Income
Gross amount from sales of assets other than inventory	Capital Gain Income (net with Cost)
Less: cost or other basis and sales expenses	Capital Gain Income (net with Cost)
Net gain or (loss)	Capital Gain Income
Gross revenue from special events and activities	Gross Receipts or Sales
Cost of goods sold from special events and activities	Cost of Goods Sold
Gross sales of inventory, less returns and allowances	Gross Receipts or Sales
Less: cost of goods sold	Cost of Goods Sold
Other Revenue	Other Income

<i>Expenses 6, 7 & 8</i>	
Form 990 Description	Form 1120 Description
Grants and allocations	Charitable Contributions, if qualified
Specific assistance to individuals	Other Deductions, if qualified
Benefits paid to or for members	Other Deductions, if qualified 4
Compensation of officers, directors, etc.	Compensation of Officers
Other salaries and wages	Salaries and Wages

Exhibit 4.75.31-7 (Cont. 1) (07-17-2017)
Form 990 to Form 1120 Conversion Table

Form 990 Description	Form 1120 Description
Pension plan contributions	Pension, profit-sharing, etc., plans
Other employee benefits	Employee benefits programs
Payroll taxes	Taxes and Licenses
Professional fund-raising fees	Other Deductions, if qualified
Accounting fees	Other Deductions
Legal fees	Other Deductions
Supplies	Other Deductions
Telephone	Other Deductions
Postage and shipping	Other Deductions
Occupancy	Rents
Equipment rental and maintenance	Repairs and Maintenance
Printing and publications	Other Deductions
Travel	Other Deductions
Conferences, conventions, and meetings	Other Deductions
Interest	Interest
Depreciation, depletion, etc.	Depreciation or Depletion, if qualified
Other expenses	Other Deductions

- 1 IRC 61, Gross Income Defined. As a general rule, all income is taxable unless proven otherwise.
- 2 IRC 102, Gift and Inheritances. As a general rule, gross income does not include the value of property acquired by gift, bequest, devise, or inheritance. *See also: *Synanon Church v. Commissioner*, T.C. Memo. 1989-270 (Docket No. 20015-84). See Exhibit CPE 1990, *Taxation of Revoked Tax-Exempt Organizations: The Synanon Case*, and General Counsel Memorandum 39813. (Not citable as legal precedent)
- ** Issues Examiner should consider:
 - 1) Was there a good faith solicitation?
 - 2) Was there a good faith contribution?
- 3 Government Grants are not excludable income under IRC 102.
- 4 IRC 277, Deductions by Certain Membership Organizations [non 501(c)(3)]. As a general rule, deductions shall be allowed only to the extent of income derived during such year from members or transactions with members.
 - * 501(c)(3) - generally deductible
 - ** Examiners need to distinguish between contributions and gross receipts.

Exhibit 4.75.31-7 (Cont. 2) (07-17-2017)
Form 990 to Form 1120 Conversion Table

Scenarios would be:

- 1) All classified as contributions with member benefits all deductible.
- 2) Quid-pro-quo - only partially contributions and only partially deductible.
- 3) Member services for member benefits - where no part is attributable to charitable purpose, would not be deductible.
- 5 IRC 470, Property Leased to an Exempt Organization. If a corporation leases property to a governmental or other tax-exempt entity, the corporation cannot claim deductions related to the property to the extent that they exceed the corporation's income from the lease payments.
- 6 IRC 162, Trade of Business Expenses. Examiners should be aware of the "Income Offset Rules" for deductibility of expenses.
- 7 IRC 263 and 263A, Capital Expenditures. Generally requires corporations to capitalize, or include in inventory certain costs incurred in connection with real property and inventory. *Please be aware that this section applies to Form 990 as well*
- 8 IRC 183, Activities not engaged in for profit. As a General Rule, in the case of an activity engaged in by an individual or an S Corporation, if such activity is not engaged in for profit, no deduction attributable to such activity shall be allowed under this chapter [26 USCS §§ 1 et. seq.] except as provided in this section.