

**Department of Treasury  
Internal Revenue Service**

Release Number: **200844021**

Release Date: 10/31/08

Date: 8/4/08

UIL Code: 501.03-01

Legend

ORG = Organization

ORG

ADDRESS

XX = Date      Address = address

Person to Contact:

Identification Number:

Telephone Number:

In Reply Refer to: TE/GE Review

EIN:

LAST DATE FOR FILING A PETITION  
WITH THE TAX COURT: \_\_\_\_\_

Dear Sir or Madam:

This is a Final Adverse Determination Letter as to your exempt status under section 501(c)(3) of the Internal Revenue Code.

Our adverse determination was made for the following reasons:

Organizations exempt from Federal income tax under section 501(c)(3) of the Code are required to operate exclusively for charitable, educational, or other exempt purposes. Organizations are not operated exclusively for exempt purposes if the net earnings of the organization inure in whole or in part to the benefit of private shareholders or individuals of the organization. See Treas. Reg. section 1.501(c)(3)-1(c)(2). During 20XX, 20XX, and 20XX we have determined your net earnings inured to the benefit of individuals having personal and private interests in the activities of your organization by regularly issuing checks to "cash", which were then converted to cash by these individuals and without substantiating the purpose of the expenditures. Moreover, there were no contemporaneous recording of the expenditures as salary or compensation to the individuals who cashed the checks. The funds inuring to these individuals were substantial in comparison to your total expenditures and were multiple or repeated over a pattern of years. You have not implemented safeguards to prevent a recurrence of funds inuring to your founder. A prior examination of your organization revealed a similar lack of compliance with exemption requirements. As such you have not operated exclusively for exempt purposes and have operated for the benefit of the private interests of private shareholders or individuals of your organization in contravention of the requirements of Treas. Reg. section 1.501(c)(3)-1(d)(1)(ii).

Based upon these reasons, we are retroactively revoking ORG'S IRC section 501(c)(3) tax exempt status to January 1,<sup>1</sup>

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code.

You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the year ending December 31, 20XX, and for all years thereafter.

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

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

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

You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling \_\_\_\_\_ or writing to: Internal Revenue Service, Taxpayer Advocates Office.

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

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

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

Sincerely yours,

Vicki L. Hansen  
Acting, Director EO Examinations

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
<b>Explanation of Items</b>		
<b>Name of Taxpayer</b>	<b>Tax Identification Number</b>	<b>Year/Period ended</b>
ORG		12/31/20XX, 12/31/20XX & 12/31/20XX

**LEGEND**

ORG = Organization name      XX = Date      Address = address      motto = motto  
 BM-1 = 1<sup>st</sup> board member      City = city      Service = service      employees = employees

**Issue:**

Whether the organization qualifies for exemption under section 501(c) (3) after being involved in repeated excess benefit transactions, failing to file required tax returns/information returns, and failing to comply with rules and regulations to provide the information required for the continuation of an exempt status.

**Facts:**

The organization is a motto formed to provide service to children living in a low-income area of City. A staff of employees was hired by the motto to take care of approximately 40 to 50 children during weekdays. Classes were also offered to provide motto education to the children attending the school. Exemption under section 501(c) (3) was granted to the organization for furthering a charitable purpose. Most of its revenue came from tuition fees paid by parents for their children attending the motto, and it was qualified as a publicly supported organization under section 509(a) (2). The organization has been required to file an annual information return of Form 990 since it was granted exempt status in 19XX.

An examination was planned for the organization's Form 990 for tax year 20XX. After an explanation was given to the director for this examination, and after an appointment letter, together with the publication of Your Rights as a Taxpayer, was sent to the organization for the examination, the officers/directors of the organization kept finding reasons not to keep any appointment and not to start the examination. A summons was later issued to the president of the organization for documents/ information needed to start the examination after there was no response from the organization for more than eight months. Still, only after the counsel attorney of IRS issued a "no-response letter" to the president for not complying with tax law and warned of taking the organization to a Federal court, did the organization name a CPA as Power of Attorney to represent them in this examination.

Since the examination finally started after more than ten months of delay, only a limited number of documents were ever provided by the organization. There were only two types of recordings provided as accounting records for 20XX. One recording was a notebook with written-down figures of tuition payments received from parents for their children attending the motto. No other type of revenue figures, such as receipts from government grants, was found in the notebook. There was no way of telling how any of the figures shown in the notebook were tied to deposits to the organization's bank

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
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ORG		12/31/20XX, 12/31/20XX & 12/31/20XX

account, or tied to revenue figures shown on the tax return. However, it was obvious that the total amount recorded as tuition receipts in the notebook was \$ for 20XX, while revenue reported on the tax return as program service revenue for the same year was only \$.

Another recording was an expense summary listing the checks issued by the organization in different expense types. This summary is a computer print-out prepared by the Power of Attorney/CPA at the time when the inspection of the documents/information just began. There was a sub-total figure for each different type of expense. However, there was also no way of telling how any of these expense figures were tied to expenditures shown on the tax return. The total amount of expenses shown on the summary was \$ for 20XX, while that reported on the tax return was only \$.

Among all the expense items incurred for 20XX, those classified as food expenses, school expenses and salaries constituted the biggest part of the discrepancy. However, not even one invoice was provided to substantiate any of the said food expenses or school expenses. Many of the cancelled checks provided to prove those expenses showed no names of payees (but only the word "cash") on the front side, and were endorsed by the organization's president (with his signature), or the executive director (with her signature), on the back side. The amount of all such checks cashed by the president/director totaled \$ for 20XX.

No returns of Form 990 were filed for 20XX and 20XX. No accounting books or records of any type were ever provided for those two years either. However, by inspecting the cancelled checks of the organization's bank account for those two years, it was found that the president/director continued their same way of cashing checks, with the total amounts of \$ and \$ respectively, for 20XX and 20XX. None of the checks cashed by the president/director were ever reported on any return filed by the organization, while only an insignificant amount of \$ was recorded on the expense summary as consulting fees paid to the executive director for 20XX. None of those amounts were ever reported on the president's/director's individual tax returns, such as Form 1040, either. In fact, this president and this executive director of the organization, being husband and wife, did not file any individual tax return for years 20XX, 20XX and 20XX.

There were also other payments classified by the organization as salaries to employees/consultants, but not reported on either Form 990 or Form 941 for 20XX. Such payments totaled \$ for six persons during the year, payments to each of whom were all more than \$. No information returns (either Form W-2 or Form 1099) were filed for any of the six employees/consultants.

By inspecting the cancelled checks, it was further found that there were questionable payments made to two persons in 20XX, and four persons/entities in 20XX. Payments

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made to each such payee exceeded \$ for the year, but no explanation and no substantiation were provided for any such payment. No information returns, such as Form 1099, were filed for any of those payees.

In 20XX, the IRS conducted an examination of the organization's 990 return for the year ended December 31, 19XX. The examination closed as a "No Change With Advisory," leaving the exempt status intact, but disclosing discrepancies noted during the examination and providing advisory statements with a future referral notice. The summary of the seven discrepancies are as follows:

1. The reported gross receipts did not agree with the financial records. The organization did not provide an explanation for the discrepancies.
2. Parts of bank statements were missing.
3. No record of receipts or documentation provided to explain the cash withdrawals from the two bank accounts. The organization stated the cash withdrawals were for food purchased and rents.
4. Some canceled checks were missing.
5. No explanation or documentation for several funds transferred to BM-1.
6. No invoices, bills, or receipts in regards to the sample checks selected for review.
7. The organization issued Forms 1099 instead of Forms W-2 to its officers. The RA also provided the related Law and Regulations to advise the organization to correct the discrepancies to avoid losing its exempt status.

**LAW:**

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

Section 1.501(c)(3)-1(c)(2) provides that an organization is not operated exclusively for exempt purposes and, thus, is not described in section 501(c)(3), if any of its net earnings inure to the benefit of a private shareholder or individual.

Internal Revenue Service section 501(c) (3) specifies that an exempt organization described therein is one in which "no part of the net of earnings inures to the benefit of any private shareholder or individual." The words "private shareholder or individual" in section 501 to refer to persons having a personal and private interest in the activities of the organization. Treas. Reg. Section 1.501(a)-1(c). The inurement prohibition provision "is designed to prevent the siphoning of charitable receipts to insiders of the charity...." United Cancer Council v. Commissioner, 165 F.3d 1173 (7<sup>th</sup> Cir. 1999).

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Reasonable compensation does not constitute inurement. Birmingham Business College v. Commissioner, 276 F.2d 476, 480 (5<sup>th</sup> Cir. 1960).

In the court case of Better Business Bureau vs. United States, 326 U.S. 279 (1945), it was held that regardless of the number of truly exempt purposes, the presence of a single substantial non exempt purpose will preclude exemption under section 501(c)(3) of the Code.

Section 6033 of the Code provides that every organization exempt from taxation under section 501(a) shall file an annual return, stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the internal revenue laws as the Secretary may by forms or regulations prescribe, and shall keep such records, render under oath such statements, make such other returns, and comply with such rules and regulation as the Secretary may from time to time prescribe.

Section 61(a) of the Code holds that gross income means all income from whatever source derived.

Section 6033(a)(1) of the Code states that every organization exempt from taxation under section 501(a) shall file an annual return, stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the internal revenue laws.

Regulation section 1.6001-1 provides that organizations shall keep permanent books of account or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown in any return of such tax or information. Such organizations shall also keep such books and records as are required to substantiate the information required by section 6033.

Regulation section 1.6033-2(i)(2) provides that every organization which is exempt from tax shall submit such additional information as may be required by the Internal Revenue Service for the propose of inquiring into its exempt status.

Revenue Ruling 59-95 held that an organization's failure or inability to file the required information return or otherwise to comply with the provision of section 6033 of the Code and the regulations which implement it, may result in the termination of the exempt status of an organization previously held exempt, on the grounds that the organization has not established that it is observing the conditions required for the continuation of an exempt status.

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In the court case of Church of Gospel Ministry vs. United States, 640 F. Supp 96, it was ruled that a failure to keep and present accurate and adequate records prevented the Church from meeting its burden of showing that its operations were primarily for charitable purposes and did not inure to the private benefit of its officers. It was stated that "the lack of adequate records or receipts makes it impossible for CGM to establish that it is not being operated for the private benefit of its members and provides independent grounds for rejecting its claim to tax-exempt status."

**Government's Position:**

The organization does not qualify as an organization described in IRC Section 501(c) (3) because (1) it did not file an annual returns for 20XX and 20XX, it omitted substantial portion of its gross income on it Form 990 for 20XX, and it did not keep or provide enough records to comply with Section 6033, (2) it results in inurement of a substantial portion of its gross receipts to the benefit of its officers and directors.

The organization did not maintain permanent books and records sufficient enough to establish the amounts of gross income, expenditures, and assets shown on its information return of Form 990 for 20XX. It did not file the required Form 990s for 20XX and 20XX.

The organization failed to provide requested documentation detailing the purposes for significant expenditures made via cashing checks. According to its financial records and records obtained from the banks, the organization had gross receipts at \$ in 20XX, \$ in 20XX, and \$ in 20XX. The funds were transferred to the president/director at \$ in 20XX, \$ in 20XX, and \$ in 20XX. It resulted in inurement of its gross receipts to its president/directors. In the absence of any proof that these payments were for the organization's operations, the payments will be treated as inurement of its charitable assets to its insiders. Also, by refusing to provide the information/documentation needed for inquiring into its exempt status, the organization was not observing the conditions required for continuation of an exempt status.

The organization was noticed by prior RA to maintain adequate records to avoid losing its exempt status upon the close of examination of its 990 return for year 19XX. The organization was also advised to operate exclusively for exempt purposes and no part of the net earnings is to benefit any private shareholder or individual.

The exempt status of the organization under section 501(c) (3) should be revoked, accordingly.

**Taxpayer's Position:**

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The organization's accounting records were sufficient to establish the amounts reported on Form 990 for 20XX. No private benefits were given by the organization to any disqualified persons.

**Conclusion:**

No explanation was provided as to why Forms 990 were not filed for 20XX and 20XX or why no accounting books and records for those two years were ever provided upon continued request. In addition, no explanation was given as to why no documentation was ever provided to substantiate the claimed expenditures in question.

Since the organization was not complying with the provisions of the Internal Revenue Code and the regulations regarding exempt status of an organization, it has not established that it is observing the conditions required for the continuation of an exempt status. It has also not established that it is being operated for reasons other than the private benefit of its officers.

The organization's exempt status under section 501(c) (3) should be revoked, effective as of January 1, 20XX.

Form 1120 returns should be filed for the tax periods ending December 31, 20XX.





TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY

Internal Revenue Service  
300 N. Los Angeles St., MS 7300  
Los Angeles, CA 90012

ORG  
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear

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

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

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

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

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

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

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

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

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez  
Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Report of Examination