



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
TE/GE EO EXAMINATIONS
1100 COMMERCE ST. MAIL STOP 4920 DAL
DALLAS, TEXAS 75242

501.03-00

February 20, 2013

Release Number: **201329019**

Release Date: 7/19/2013

LEGEND

ORG – Organization name

XX – Date Address - address

Date: February 20, 2013

Taxpayer Identification Number:

Person to Contact:

Employee Identification Number:

Contact Numbers:

(Phone)

(Fax)

ORG

ADDRESS

CERTIFIED MAIL

Dear :

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (the Code). Our favorable determination letter to you dated November 4, 19XX is hereby revoked and you are no longer exempt under section 501(a) of the Code effective January 1, 20XX.

The revocation of your exempt status was made for the following reasons:

You failed to provide documents to establish that you operated exclusively for exempt purposes, and that no part of your net earnings inured to the benefit of private shareholders or individuals. (Code section 501(c)(3)) You failed to keep adequate books and records. (Code section 6001)

Federal income tax exemption is precluded if net earnings inure to the benefit of private shareholders or individuals. (Treasury Regulation 1.501(c)(3)-1(c)(2))

We previously examined your records for 20XX, and found inurement. We pursued correction of the inurement. In reviewing your records for 20XX and 20XX, we again found inurement. You paid the personal expenses of your officers and did not maintain documentation to support the business purposes of the expenditures.

Contributions to your organization are no longer deductible.

You are required to file income tax returns on Form 1120. If you have not already filed these returns and the examiner has not provided you instructions for converting your previously filed Forms 990 to Forms 1120, you should file these income tax returns with the appropriate Service Center for the tax year ending December 31, 20XX, and for all tax years thereafter in accordance with the instructions of the return.

Processing of income tax returns and assessments 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, you may file an action for declaratory judgment under the provisions of section 7428 of the Code in one of the following three venues: United States Tax Court, the United States Court of Federal Claims, or the United States District Court for the District of Columbia. A petition or complaint in one of these three courts must be filed before the 91st day after the date this determination was mailed to you if you wish to seek review of our determination. Please contact the clerk of the respective court for rules and the appropriate forms regarding filing petitions for declaratory judgment by referring to the enclosed Publication 892. Please note that the United States Tax Court is the only one of these courts where a declaratory judgment action can be pursued without the services of a lawyer. You may write to the courts at the following addresses:

You also have the right to contact the Office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal Appeals process. The Taxpayer Advocate 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 contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely yours,

Nanette M. Downing
Director, EO Examinations

Enclosures:

Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*
Form 6018, *Consent to Proposed Action - Section 7428*

Internal Revenue Service
Tax Exempt and Government Entities Division
Exempt Organizations: Examinations
Attention: Jeffrey Davis, MailStop 39
4905 Koger Boulevard, Suite 102
Greensboro, NC 27407

Department of the Treasury

Date: September 4, 2013
Taxpayer Identification Number:
Form:
Tax Year(s) Ended:
Person to Contact/ID Number:
Contact Numbers:
 Telephone:
 Fax:
Manager's name/ID number:
Manager's contact number:
Response due date:

ORG
ADDRESS

Certified Mail – Return Receipt Requested

Dear :

Why you are receiving this letter

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

What you need to do if you agree

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

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

If we don't hear from you

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

Effect of revocation status

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

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

If you disagree with our proposed revocation, you may request a meeting or telephone conference with the supervisor of the IRS contact identified in the heading of this letter. You also may file a protest with the IRS Appeals office by submitting a written request to the contact person at the address listed above within 30 calendar days from the date of this letter.

The Appeals office is independent of the Exempt Organizations division and resolves most disputes informally.

For your protest to be valid, it must contain certain specific information including a statement of the facts, the applicable law, and arguments in support of your position. For specific information needed for a valid protest, please refer to page one of the enclosed Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*, and page six of the enclosed Publication 3498, *The Examination Process*. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process. Please note that Fast Track Mediation referred to in Publication 3498 generally doesn't apply after we issue this letter.

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

Contacting the Taxpayer Advocate Office is a taxpayer right

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

For additional information

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

Thank you for your cooperation.

Sincerely,

Nanette M. Downing
Director, EO Examinations

Enclosures:
Report of Examination
Form 6018
Publication 892
Publication 3498

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS		Schedule number or exhibit
Name of taxpayer ORG	Tax Identification Number EIN	Year/Period ended 12/31/20XX 12/31/20XX	

LEGEND

ORG - Organization name EIN - ein XX - Date City - city State - state
Country - country BOOK - book President - president
Secretary - secretary CO-1 - 1st COMPANY

ISSUE:

Whether ORG qualifies for exemption under Section 501(a) as described in Section 501(c)(3) of the Internal Revenue Code?

FACTS:

ORG (the Organization) was formed and incorporated in the state of City on April 23, 19XX as "CO-1". The Organization was granted exemption from federal income taxes under Internal Revenue Code (IRC) §501(a) as described in §501(c)(3) and further described in §170(b)(1)(A)(vi), under an advanced ruling on November 4, of 19XX. After the advanced ruling period, the Organization was granted its final determination letter on November 25, 19XX to remain exempt as described above. CO-1 later changed its name to ORG (a date of the name change could not be obtained from the City Secretary of State website).

The Organization was selected for examination due to an informant referral of suspicious activity that led to a civil complaint against the Organization. The referral questioned the use of the funds given to the Organization and felt the officers of the Organization, President, President, and Secretary, Secretary and Treasurer, were using the Organization's funds for their personal expenses. The informant also had an outstanding civil lawsuit against the Organization and President for the return of money loaned to the Organization.

After refusing multiple contact attempts, a report was prepared indicating the Internal Revenue Service's (IRS) intent to propose revocation of the Organization's tax exempt status because it failed to provide the information required by the IRS for the purposes of inquiring into its tax exempt status. The report was mailed to the President's post office box, via certified mail, on April 20, 20XX.

A phone call was received on May 9, 20XX from Secretary regarding the correspondence received proposing revocation of its tax exempt status, and the Organization's available options. Secretary was notified that the organization had two (2) options:

1. Allow the examination of their books and records, or
2. In the event the organization does not want to agree to allow the examination, receive a 2-week extension for the formal appeal due date.

Secretary indicated that they would allow for the examination of its books and records.

The examination of the Organization yielded that its activities included spreading the gospel of Christianity throughout the country and world. The Organization is operated solely by President & Secretary to spread the Christian gospel; the Organization would achieve its goal by producing books, CDs, radio programs, televised programs, traveling house-to-house, and traveling to different churches. The Organization has traveled from State, State, State, State, State, and even parts of Country spreading the gospel of Christianity in person and on television broadcasts.

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The Organization's Board of Directors met annually in the month of December. The Board consisted only of President, the Organization's President, and Secretary, the Organization's Secretary/Treasurer. The meeting minutes of the Board of Directors consisted of a summary of the Organization's activities throughout the year. The meeting minutes listed the worldwide locations in which it traveled to spread the gospel of Christianity, described the publishing and production of a book "BOOK" written by President, the production and recording of television programs, the Organization's plan for the following year to produce more books and television programs, and its travel plans for the following year. The meeting minutes also indicated that the Organization decided to move to City, State in 20XX, and relocate to City, State in the spring of 20XX. The Board of Directors meeting minutes were devoid of financial reports and also lacked discussions about personal expenditures made by President and Secretary. The Board of Directors meeting minutes that were reviewed provided no evidence of financial oversight regarding the operations of the Organization, and no evidence that President or Secretary had any limitations on their authority to expend money.

To support its activities, the Organization received "love offerings" or contributions from individuals and churches. The Organization also sent letters once or twice a month to "partners", individuals and churches the Organization has helped in the past, on its mailing list to solicit contributions. When asked about the workings of the Organization's financial assets and bank account(s), President & Secretary indicated that only they have access to the Organization's accounts, and they determine how all the money is spent.

The Organization's expenses were reviewed to determine whether the Organization's income was being used for the furtherance of its tax exempt purpose. Review of the bank statements yielded that the Organization incurred various questionable expenses. The Organization incurred many ATM cash withdrawals, restaurant expenses, grocery expenses, medical expenses, gas station and convenient store expenses, home improvement store expenses, department store expenses, and mortgage and rent expenses. Although requested on an Information Document Request (IDR) dated May 16, 20XX, the Organization did not provide any cancelled checks, receipts, invoices, vouchers, or any other source documents to determine the legitimate business reason for the expenses. Upon discovery of the questionable expenses during the 20XX tax year, the examination was expanded to include the 20XX tax year.

A letter was prepared and mailed to the President's post office box, along with an additional IDR, on June 8, 20XX. The IDR requested information for the tax year ending December 31, 20XX, as well as information originally requested on the IDR dated May 16, 20XX for the 20XX tax year, but not provided. Cancelled checks, receipts, invoices, vouchers, and any other source documents that verify the amount of expenses reported for the 20XX and 20XX tax years were requested. Additional bank statements were also requested for all the Organization's accounts, in particular accounts in which transfers between accounts were noticed.

The Organization's response to the latest IDR was received on June 22, 20XX. Along with other requested information, The Organization provided information regarding a PayPal® account for the 20XX tax year, as well as additional bank statements, and information regarding some of the transfers between accounts discovered during the 20XX tax year.

After review of the information received on June 22, 20XX, it was discovered that the Organization again failed to provide a comprehensive collection of bank statements, cancelled checks, receipts,

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invoices, vouchers, and any other source documents that verify the amount of expenses reported for the 20XX and 20XX tax years. An additional IDR was prepared and mailed to the Organization on July 14, 20XX to again request bank statements, cancelled checks, receipts, invoices, vouchers, and any other source documents that verify the amount of expenses reported for the 20XX and 20XX tax years.

After receipt of the IDR, a telephone call was received from Secretary on July 22, 20XX indicating that the Organization did not have copies of receipts, invoices, or source documents, and that it was not cost-effective for the Organization to obtain the cancelled checks from the bank. Secretary also inquired if the Service would request the information from the bank directly. Secretary was notified that the source documents are needed to determine whether the Organization's expenses qualify as business expenses and not personal. Secretary was also told that the Service would not acquire the cancelled checks from the bank directly because it is the Organization's responsibility to substantiate its Form 990 return, and maintaining cancelled checks and source documents is how the an organization can authenticate what it reported on its Form 990 return; without the information, it could result in the expenses of the Organization being reclassified as income to the officers.

The Organization's initial response to the IDR dated July 14, 20XX was received on August 3, 20XX. The Organization submitted some bank statements, but indicated that more bank statements, as well as receipts that were found that span the 20XX and 20XX tax years, and would be sent in a separate package. Additional responses to the IDR dated July 14, 20XX were received August 12, 20XX, August 15, 20XX, August 16, 20XX, and August 23, 20XX.

The Organization submitted for review many loose receipts that accounted for purchases and expenses paid fore during the 20XX and 20XX tax year, some of which were not legible. The Organization did not provide any written explanations or any other additional supporting information regarding the receipts.

The receipts and invoices provided by the Organization were reviewed against the transactions discovered in the Organization's bank statements. The provided receipts included numerous restaurant receipts, grocery expenses, medical expenses, gas station and convenient store expenses, home improvement stores, and department store expenses. The receipts did not include attachments or reports that provided indication that the expenses incurred while traveling for the Organization, or were made directly for the Organization. Many receipts and invoices indicated that the purchase was made in the name of President or Secretary, not the Organization.

The receipts that were submitted by the Organization were taken into account for determining which expenses qualified as legitimate business expenses. The Organization failed to provide any source documents to substantiate many of the questionable expenses, a written position with regard to the questionable expenses, how said expenses were ordinary and necessary business expenses and not personal in nature. The Organization did not provide invoices for expenses that occur on a monthly basis such as utility expenses.

Upon review of the canceled checks, the Organization issued checks to churches and other charitable organizations, but also issued checks for transactions that seemed personal in nature. Review of the canceled checks also yielded President and Secretary as the only signature authorities on all checks.

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President was not provided a Form W-2, Wage and Tax Statement, for the 20XX or 20XX tax years by the Organization. The Organization however reported \$ and \$ in reportable compensation to President on its Form 990 return for the 20XX and 20XX tax years respectively. No predetermined salary or wages were designated for this individual; instead, the disbursements made for personal expenses were reported as compensation on its Form 990 returns. The Organization did not provide substantiation with respect to how the above figures were reached in determining the amount of compensation for President.

President and Secretary indicated that they currently own a residence in State for which they have a mortgage, but also rented a residence in City, State (throughout 20XX) and continue to rent a residence in City, State. The Organization submitted Form 1098 Mortgage Interest statements for a residence owned in State during 20XX and 20XX, and an executed residential rental agreement for a State property during 20XX. The Organization did not submit any leasing or rental contracts for the time spent in State.

The Organization's Form 990 returns also indicated that President was paid a housing allowance of \$ and \$ for the 20XX and 20XX respective tax years. The Organization indicated that the housing allowance covered the mortgage, utilities, taxes, insurance, and maintenance and repairs to the officers' primary residence in State, as well as the officers' residences while in State and State. There was no indication that a fair market value amount was designated as housing allowance prior to the payment of the expenses.

The Organization failed to provide any source documents to substantiate many of the questionable expenses, a written position with regard to the questionable expenses, how said expenses were ordinary and necessary business expenses and not personal in nature to President and Secretary, and the basis for these expenses to be excluded from the personal income of President and Secretary. The total questionable expenses and transactions that could not be substantiated by the Organization as legitimate business expenses totaled \$ and \$ for the 20XX and 20XX tax years respectively. See EXHIBIT 1 for a breakdown of the questionable expenses.

The Organization's Form 990 return for the 20XX tax year was previously examined by the Internal Revenue Service. According to the final report of findings issued by the IRS for the prior examination, it was determined that the Organization's funds were disbursed specifically to pay for a significant amount of personal expenses. The examination concluded with President being assessed the % "first tier" tax as defined in IRC §4958(a)(1), on \$ of excess benefit transactions received (and yearly computed interest) or \$ in additional tax due.

LAW:

Internal Revenue Code (IRC) §501(a) states that an organization described in subsection (c) or (d) shall be exempt from taxation under this subtitle unless such exemption is denied under Section 502 (concerning feeder organization) or Section 503 (concerning organizations engaged in prohibited transactions).

IRC §501(c) identifies in its subparagraphs the list of organizations referred to in subsection (a).

IRC §501(c)(3) exempts from taxation, corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary,

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or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene in any political campaign on behalf of (or in opposition to) any candidate for public office.

IRC §501(d) states that the following organizations are referred to in subsection (a): Religious or apostolic associations or corporations, if such associations or corporations have a common treasury or community treasury, even if such associations or corporations engage in business for the common benefit of the members, but only if the members thereof include (at the time of filing their returns) in their gross income their entire pro rata shares, whether distributed or not, of the taxable income of the association or corporation for such year. Any amount so included in the gross income of a member shall be treated as a dividend received.

IRC §509(a) states in part for purposes of this title, the term "private foundation" means a domestic or foreign organization described in section 501(c)(3) other than

(1) an organization described in section 170(b)(1)(A), other than clauses vii and viii,

(2) an organization which

(A) normally receives more than one-third of its support in each taxable year from any combination of —

(i) gifts, grants, contributions, or membership fees, and

(ii) gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in an activity which is not an unrelated trade or business, not including such receipts from any person, or from any bureau or similar agency of a governmental unit, in any taxable year to the extent such receipts exceed the greater of \$5,000 or 1 percent of the Organization's support in such taxable year,

from persons other than disqualified persons (as defined in §4946) with respect to the organization, from governmental units, or from organizations described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)), and

(B) normally receives not more than one-third of its support in each taxable year from the sum of —

(i) gross investment income and

(ii) the excess (if any) of the amount of the unrelated business taxable income over the amount of the tax imposed by section 511.

IRC §170(b)(1)(A)(vi) states in part that an organization that normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its

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charitable, educational, or other purpose or function constituting the basis for its exemption under section 501(a)) from a governmental unit or from direct or indirect contributions from the general public.

IRC §162(a) states in part that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including —

- (1) a reasonable allowance for salaries or other compensation for personal services actually rendered;
- (2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business; and
- (3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

IRC §262 provides in part that

- (a) Except as otherwise expressly provided, no deduction shall be allowed for personal, living, or family expenses.
- (b) For purposes of subsection (a), in the case of an individual, any charge (including taxes thereon) for basic local telephone service with respect to the 1st telephone line provided to any residence of the taxpayer shall be treated as a personal expense.

IRC §6001 states in part that every person liable for any tax imposed by this title, or for the collection thereof, shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe.

IRC §6033(a)(1) states in part that except as provided in paragraph (3), 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 regulations as the Secretary may from time to time prescribe.

IRC §6033(a)(3)(A) states in part that the above paragraph shall not apply to —

- (i) churches, their integrated auxiliaries, and conventions or associations of churches,
- (ii) any organization (other than a private foundation, as defined in section 509(a)) described in subparagraph (C), the gross receipts of which in each taxable year are normally not more than \$5,000, or

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(iii) the exclusively religious activities of any religious order.

Treasury Regulation §1.501(a)-1(c) states that the words "private shareholder or individual" in section 501 refer to persons having a personal and private interest in the activities of the organization.

Treasury Regulation §1.501(c)(3)-1(c)(1) states in part that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

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

Treasury Regulation §1.501(c)(3)-1(d)(1) states in general

(i) An organization may be exempt as an organization described in section 501(c)(3) if it is organized and operated exclusively for one or more of the following purposes:

- (a) Religious,
- (b) Charitable,
- (c) Scientific,
- (d) Testing for public safety,
- (e) Literary,
- (f) Educational, or
- (g) Prevention of cruelty to children or animals.

(ii) An organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Treasury Regulation §1.501(c)(3)-1(f)(2)(ii) states in part that in determining whether to continue to recognize the tax-exempt status of an applicable tax-exempt organization described in section 501(c)(3) that engages in one or more excess benefit transactions that violate the prohibition on inurement under section 501(c)(3), the Commissioner will consider all relevant facts and circumstances, including, but not limited to, the following —

(A) The size and scope of the organization's regular and ongoing activities that further exempt purposes before and after the excess benefit transaction or transactions occurred;

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- (B) The size and scope of the excess benefit transaction or transactions (collectively, if more than one) in relation to the size and scope of the organization's regular and ongoing activities that further exempt purposes;
- (C) Whether the organization has been involved in multiple excess benefit transactions with one or more persons;
- (D) Whether the organization has implemented safeguards that are reasonably calculated to prevent excess benefit transactions; and
- (E) Whether the excess benefit transaction has been corrected (within the meaning of section 4958(f)(6), meaning in respect to any excess benefit transaction, undoing the excess benefit to the extent possible, and taking any additional measures necessary to place the organization in a financial position not worse than that in which it would be if the disqualified person were dealing under the highest fiduciary standards), or the organization has made good faith efforts to seek correction from the disqualified person(s) who benefited from the excess benefit transaction.

Treasury Regulation §1.501(c)(3)-1(f)(2)(iii) states that all factors will be considered in combination with each other. Depending on the particular situation, the Commissioner may assign greater or lesser weight to some factors than to others. The factors listed in paragraphs (f)(2)(ii)(D) and (E) of this section will weigh more heavily in favor of continuing to recognize exemption where the organization discovers the excess benefit transaction or transactions and takes action before the Commissioner discovers the excess benefit transaction or transactions. Further, with respect to the factor listed in paragraph (f)(2)(ii)(E) of this section, correction after the excess benefit transaction or transactions are discovered by the Commissioner, by itself, is never a sufficient basis for continuing to recognize exemption.

Treasury Regulation §1.501(c)(3)-1(f)(3) states that the rules in paragraph (f) of this section will apply with respect to excess benefit transactions occurring after March 28, 20XX.

Treasury Regulation §1.162-1(a) states in part that business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except items which are used as the basis for a deduction or a credit under provisions of law other than §162.... Among the items included in business expenses are management expenses, commissions, labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business, advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property.... The full amount of the allowable deduction for ordinary and necessary expenses in carrying on a business is deductible, even though such expenses exceed the gross income derived during the taxable year from such business.

Treasury Regulation §1.162-17(d)(1) states that although the Commissioner may require any taxpayer to substantiate such information concerning expense accounts as may appear to be pertinent in determining tax liability, taxpayers ordinarily will not be called upon to substantiate expense account information except those in the following categories:

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- (i) A taxpayer who is not required to account to his employer, or who does not account;
- (ii) A taxpayer whose expenses exceed the total of amounts charged to his employer and amounts received through advances, reimbursements or otherwise and who claims a deduction on his return for such excess;
- (iii) A taxpayer who is related to his employer within the meaning of section 267(b); and
- (iv) Other taxpayers in cases where it is determined that the accounting procedures used by the employer for the reporting and substantiation of expenses by employees are not adequate.

Treasury Regulation §1.162-17(d)(2) states that the Code contemplates that taxpayers keep such records as will be sufficient to enable the Commissioner to correctly determine income tax liability. Accordingly, it is to the advantage of taxpayers who may be called upon to substantiate expense account information to maintain as adequate and detailed records of travel, transportation, entertainment, and similar business expenses as practical since the burden of proof is upon the taxpayer to show that such expenses were not only paid or incurred but also that they constitute ordinary and necessary business expenses. One method for substantiating expenses incurred by an employee in connection with his employment is through the preparation of a daily diary or record of expenditures, maintained in sufficient detail to enable him to readily identify the amount and nature of any expenditure, and the preservation of supporting documents, especially in connection with large or exceptional expenditures. Nevertheless, it is recognized that by reason of the nature of certain expenses or the circumstances under which they are incurred, it is often difficult for an employee to maintain detailed records or to preserve supporting documents for all his expenses. Detailed records of small expenditures incurred in traveling or for transportation, as for example, tips, will not be required.

Treasury Regulation §1.162-17(d)(3) states that where records are incomplete or documentary proof is unavailable, it may be possible to establish the amount of the expenditures by approximations based upon reliable secondary sources of information and collateral evidence. For example, in connection with an item of traveling expense a taxpayer might establish that he was in a travel status a certain number of days but that it was impracticable for him to establish the details of all his various items of travel expense. In such a case rail fares or plane fares can usually be ascertained with exactness and automobile costs approximated on the basis of mileage covered. A reasonable approximation of meals and lodging might be based upon receipted hotel bills or upon average daily rates for such accommodations and meals prevailing in the particular community for comparable accommodations. Since detailed records of incidental items are not required, deductions for these items may be based upon a reasonable approximation. In cases where a taxpayer is called upon to substantiate expense account information, the burden is on the taxpayer to establish that the amounts claimed as a deduction are reasonably accurate and constitute ordinary and necessary business expenses paid or incurred by him in connection with his trade or business. In connection with the determination of factual matters of this type, due consideration will be given to the reasonableness of the stated expenditures for the claimed purposes in relation to the taxpayer's circumstances (such as his income and the nature of his occupation), to the reliability and accuracy of records in connection

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with other items more readily lending themselves to detailed record-keeping, and to all of the facts and circumstances in the particular case.

Treasury Regulation §53.4958-4(c)(1) states in part that an economic benefit is not treated as consideration for the performance of services unless the organization providing the benefit clearly indicates its intent to treat the benefit as compensation when the benefit is paid. An applicable tax-exempt organization is treated as clearly indicating its intent to provide an economic benefit as compensation for services only if the organization provides written substantiation that is contemporaneous with the transfer of the economic benefit at issue. If an organization fails to provide this contemporaneous substantiation, any services provided by the disqualified person will not be treated as provided in consideration for the economic benefit for purposes of determining the reasonableness of the transaction.

Treasury Regulation §53.4958-4(c)(3)(i)(A) states in part that contemporaneous substantiation can be demonstrated by:

- (1) The organization reporting the benefit as compensation on an original or amended Federal tax information return with respect to the payment (e.g. Form W-2, 1099 or 990) provided that the amended form is filed before an examination has been started on the organization or disqualified person; or
- (2) The disqualified person reporting the benefit as income on an original or amended Form 1040, provided that the amended Form 1040 is filed before an examination has been started on the organization or disqualified person.

Treasury Regulation 1.6001-1(a) in conjunction with Treas. Reg. 1.6001-1(c) states in part that every organization exempt from tax under IRC 501(a) must keep such permanent books or accounts or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other materials required to be shown by such person in any return of such tax. Such organization shall also keep such books and records as are required to substantiate the information required by IRC 6033.

Treasury Regulation 1.6001-1(e) states that the books or records required by this section shall be kept at all times available for inspection by authorized internal revenue officers or employees, and shall be retained as long as the contents thereof may be material in the administration of any internal revenue law.

Treasury Regulation 1.6033-2(i)(2) states in part that every organization which is exempt from tax, whether or not it is required to file an annual information return, shall submit such additional information as may be required by the Internal Revenue Service for the purpose of inquiring into its exempt status.

Revenue Ruling 59-95 concerns an organization previously held exempt from Federal income tax was requested to produce a financial statement as of the end of the year and a statement of its operations during such year. However, its records were so incomplete that it was unable to furnish such statements. The Service held that the failure or inability to file the required information return or otherwise to comply with the provision of IRC Section 6033 and the regulations which implement it, may result in the termination of the exempt status of an organization previously held exempt, on the

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grounds that the organization has not established that it is observing the conditions required for the continuation of an exempt status.

In Rameses School of San Antonio, Texas, v. Commissioner, T.C. Memo 20XX-85, an organization was established as a nonprofit corporation under the laws of the State of Texas for the purpose of operating a school providing education to children and initially received recognition as an organization described in IRC §501(c)(3). The Commissioner contended that the taxpayer failed the operational test imposed pursuant to Treasury Regulation §1.501(c)(3)-1(c) on grounds that the taxpayer was operated to benefit the private interests of an individual who served as the taxpayer's executive director, president, chief executive officer, and administrator (administrator), and that part of its net earnings inured to her benefit. For instance, while the taxpayer's board approved a salary of \$5,000 per month for the administrator, the taxpayer's payroll journal showed salary amounts in excess of \$5,000 per month for certain months. Although the administrator asserted that the excess amounts were awarded as reimbursement for money that she had loaned to the taxpayer, the documentation that purportedly showed such loans had been altered. The administrator made unexplained cash withdrawals on the taxpayer's account. There were also questionable lease agreements, signed only by the administrator, that were never approved by the board. The administrator contended that the taxpayer owned the property, but if this were true, the taxpayer had leased the property from itself under the owner rental agreement. The court held that the taxpayer's tax-exempt status was properly revoked.

In Rueckwald Foundation, Inc. v. Commissioner, T.C. Memo 1974-298, the taxpayer was a foundation that qualified for an exemption from federal income taxes under IRC §501(c)(3). The qualification was subject to the understanding that the taxpayer's operations conformed to those purposes stated in its application. Because it failed to obtain a state license, the taxpayer changed its purpose. The taxpayer's founder served as both its president and chairman. His mother was an invalid and his son was in college. His mother's care fell to the founder, who found himself on the verge of bankruptcy. The taxpayer entered into a number of transactions, the result of which were to provide it with income that was exclusively used by the founder to defray his family's personal expenses. The IRS revoked the taxpayer's §501(c)(3) exemption from federal income taxation and issued a notice of deficiency. The taxpayer sought a redetermination and the court affirmed. The court held that the taxpayer's income from all sources was available for the use of the founder's family, an arrangement neither approved nor permitted under I.R.C. § 501(c)(3). The court held that the taxpayer failed to show that it qualified for income tax exemption under I.R.C. §501(c)(3).

TAXPAYER'S POSITION:

ORG maintains that it has not done anything to warrant its tax exempt status revoked.

The Organization maintained that the expenses incurred by the Organization are necessary to perform and continue its activities. The Organization travels to preach and spread the gospel of Christianity throughout the country and world. This requires travel expenses which the Organization covers. The personal expenses incurred by the officers of the Organization were considered wages to President. All other expenses incurred by the Organization are necessary for the continued operation of the Organization.

GOVERNMENT'S POSITION:

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The exempt status of the ORG should be revoked because it fails the operational test imposed pursuant to Treasury Regulation §1.501(c)(3)-1(c) on grounds that the Organization inures to the benefit of private shareholders, President and Secretary.

As officers of the Organization, President and Secretary are in charge of the day-to-day operations of the Organization. President and Secretary both use the income from the Organization as they see fit. This is evidenced by the numerous expenses incurred by the Organization that are personal in nature. Purchases from nail salons, health spas, department stores, limousine services, and movie theaters in no way qualify as a legitimate business expense for an Organization whose focus is on spreading the gospel of Christianity throughout the country and world.

The Organization did not provide any documentation, mileage or automobile records, to substantiate the gas station/convenience store purchases. The Organization travels throughout the country preaching and spreading the gospel of Christianity, and indicated in its Board of Director meeting minutes places in which the Organization had traveled during the year. However, the Organization did not maintain or submit travel and mileage logs to substantiate its travel expenses. The board meeting minutes also did not specify dates in which travel to the locations indicated. The Organization failed to provide detailed accounts of all the Organization's speaking engagements, or other information to substantiate when, where, and the reason for the travel expenses. The summary of locations visited listed in the Organization's Board of Directors meeting minutes is not sufficient to allow the travel expenses claimed. According to Treasury Regulation §1.162-17(d)(2), adequate documentation should be maintained and presented to claim deductions for travel related expenses and correctly determine the proper tax liability.

Source documents, receipts, cancelled checks, and other information were requested to substantiate the Form 990 return, and the questionable transactions discovered from the Organization's bank statements. The Organization failed to provide bank statements for all accounts in which moneys were deposited, transferred, or disbursed. Multiple transfers were made to bank accounts for which no statements were provided for either the 20XX or 20XX tax years. While the Organization provided some invoices and receipts to show proof of the expense, the business purpose of the expenses could not be proven, and many receipts were deemed personal in nature. The many department store purchases, restaurant purchases, entertainment purchases, gas station/convenience store purchases, home improvement purchases, and all other expenses that could not easily be distinguished as expenses incurred by a religious organization do not qualify as ordinary and necessary business expenses as defined by IRC §162; instead, they inure to the benefit of President and Secretary because they are in charge of the day-to-day operations of the Organization.

The gross misuse of the Organization's assets for their day-to-day survival is further evidenced by President and Secretary's payment for the upkeep of two (2) residences. President and Secretary are able to maintain a residence in State, as well as State (during 20XX) or State (during 20XX) all by way of the Organization's assets. President and Secretary are the only individuals with control of the Organization's accounts. They used the Organization's assets to pay the mortgage or rent for the two (2) residences, home improvements on those residences, utilities and upkeep of the residences, medical expenses for their family, and to purchase food at grocery stores and numerous restaurants.

As officers, President and Secretary are able to receive a substantial benefit from the Organization by overseeing the day-to-day operations of the Organization as evidenced in the numerous personal

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transactions identified in EXHIBIT 1; the amount of the unsubstantiated questionable expenses totaled \$ and \$ for 20XX and 20XX respectively. President and Secretary were given credit for \$ and \$ in compensation and housing allowance reported on the Form 990 return filed by the Organization (Treasury Regulation 53.4958-4(c)(3)(i)(A) cited). Therefore, \$ of the \$ is considered to have improperly benefited the officers in the 20XX tax year, and \$ of the \$ is considered to have improperly benefited the officers in the 20XX tax year.

Because President and Secretary are in charge of the day-to-day operations and expenses of the Organization as its only officers, the \$ and \$, for 20XX and 20XX respectively, in unsubstantiated expenses are considered excess benefit transactions and inured to the benefit of the officers. The \$ in unsubstantiated expenditures during 20XX accounted for approximately % of the Organization's income, and approximately % of the Organization's expenses, while the \$ in unsubstantiated expenditures for 20XX accounted for approximately % of the Organization's income and approximately % of the Organization's expenses.

The Organization was notified during the examination of its Form 990 for the 20XX tax year of the law regarding excess benefit transactions. Excess benefit transactions received by a disqualified person that is an officer is, logically, a form of inurement. The Organization has not performed responsibly or operated with due diligence since the examination of its Form 990 for the 20XX tax year to reduce or prevent further excess benefit transactions. The Organization has continued to operate in the manner in which it operated for the 20XX tax year.

When excess benefit transactions occur, there is an inherent risk to the exempt status of the organization. Some factors to consider regarding whether an organization remains exempt under IRC §501(c)(3) are described in the subparagraphs of Treasury Regulation §1.501(c)(3)-1(f)(2)(ii). These factors are applicable to excess benefit transactions that occurred after March 28, 20XX. The transactions in which President and Secretary received an excess benefit were substantial as it relates to the size of the organization. There was little oversight in the Organization's financial operations to prevent further transactions prior to the Service's inquiry into the Organization's exempt status for the years under examination. President and Secretary also have not yet made correction for the excess benefit received. For all transactions that occurred after March 28, 20XX, based on the factors identified in the treasury regulations identified above, the Organization's tax exempt status would be in serious jeopardy. Although technically the regulations don't apply for transactions that occurred before March 28, 20XX, similar principles would apply.

According to IRC §501(c)(3), no part of the net earnings shall inure to the benefit of any private shareholder or individual; however, President and Secretary have received clothes, entertainment, and other benefits from their role in the Organization. The private benefit received by President and Secretary outweighs the benefits of the legitimate activities of the Organization. As evidenced by Rameses School of San Antonio, Texas, v. Commissioner, T.C. Memo 20XX-85, and Rueckwald Foundation, Inc. v. Commissioner, T.C. Memo 1974-298, the loss of tax exempt status is warranted in which private benefit of an individual occurs.

Not only does the Organization fail to qualify for its tax exempt status due to inuring to the benefit of a private shareholder or individual, the Organization also fails to qualify for exemption due to failing to meet the requirements of Treasury Regulation 1.6033-2(i)(2). As referenced by Revenue Ruling 59-95, an organization exempt from taxation under IRC §501(a) that fails to submit such additional information as may be required by the Internal Revenue Service for the purpose of inquiring into its

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exempt status may result in the termination of its exempt status. The Organization did not provide documentation to substantiate numerous expenses incurred by the Organization. The Organization has repeatedly been asked to submit information to the IRS for purposes of inquiring into its tax exempt status, but has failed to provide the requested information.

The Organization has failed the operational test in various ways. The inurement received by individuals, President and Secretary, outweighs the benefit of the charitable activities provided by the Organization. The Organization also failed to maintain adequate records to substantiate the information provided on its annual Form 990 return. The Organization's failures in the operational test outweigh its charitable activities; the Organization's tax exempt status should be revoked.

CONCLUSION:

ORG does not qualify for tax exempt status under Internal Revenue Code §501(a) as described in §501(c)(3). The financial inurement received by its officers, and the use of the Organization's assets by its officers for their personal use, demonstrate that the Organization has not met its obligations and responsibilities to maintain tax exempt status under section 501(c)(3) of the Code. Revocation of the tax exempt status of ORG is proposed with an effective date of January 1, 20XX.