



**DEPARTMENT OF THE TREASURY**

**INTERNAL REVENUE SERVICE**

TE/GE EO Examinations  
MS:4957:DAL  
1100 Commerce Street  
Dallas, TX 75242

501.03-00

**TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION**

March 11, 2011

Release Number: **201122023**

Release Date: 6/3/2011

LEGEND

ORG = Organization name

XX = Date

Address = address

Taxpayer Identification Number

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

ORG

ADDRESS

**CERTIFIED MAIL – RETURN RECEIPT REQUESTED**

Dear \_\_\_\_\_ :

This is a final adverse determination regarding your exempt state under section 501(c)(3) of the Internal Revenue Code (the Code). Our favorable determination letter to you dated April 28, 20XX 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:

I.R.C. § 501(c)(3) precludes Federal Income tax exemption if net earnings inure to the benefit of private shareholders or individuals. Inurement occurred when the organization allowed the president to make cash withdrawals and cash checks from the organization's checking account. In addition, inurement occurred when the president wrote checks from the organization's checking account to his wife and to pay for personal expenses. Because I.R.C. § 501(c)(3) prohibits inurement of earnings, your exempt status is hereby revoked.

Additionally, you have failed to provide such documents and information as required by Treas. Reg. § 1.6033-2(h)(2) to establish that you are organized and operated exclusively for exempt purposes within the meaning of I.R.C. § 501(c)(3), and to establish that no part of your net earnings inure to the benefit of private shareholders or

individuals. Also, you have failed to keep adequate books and records as required by I.R.C. § 6001 and the regulations thereunder.

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 your previously filed Form 990 to form 1120, you should file these 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 91<sup>st</sup> day after the date this determination was mailed to you if to 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 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 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 whose name and telephone number are shown in the heading of this letter.

Sincerely,

Nanette M. Downing  
Director, EO Examinations

Enclosures:  
Publication 892  
Form 6018, consent to Proposed Adverse Action  
Envelope

**Internal Revenue Service**

**Department of the Treasury**

Date: March 11, 2011

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,

Nan Downing  
Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Report of Examination

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX

**LEGEND**

ORG = Organization name      XX = Date      President = president      PC = PC  
 BM-1, BM-2 & BM-3 = 1<sup>ST</sup>, 2<sup>ND</sup> & 3<sup>RD</sup> BM      CO-1, CO-2, CO-3 & CO-4 = 1<sup>ST</sup>, 2<sup>ND</sup>, 3<sup>RD</sup>  
 & 4<sup>TH</sup> COMPANIES

**Issue:**

Whether ORG qualifies for exemption as a public charity under IRC Section 501(c)(3).

**Facts:**

During the initial interview, President, President of ORG, stated that the only activities during the year were three workshops designed to help prepare individuals to acquire home mortgages. These workshops occurred on August 1<sup>st</sup>, October 28<sup>th</sup> and November 11<sup>th</sup>, 20XX. President has stated no activities occurred after 20XX.

During the year under examination the President, President, wrote checks from the organization made out to cash and made cash withdrawals from the organization’s checking account. President did not have any receipts for these expenditures to show that they were for the benefit of the organization. These fourteen items totaled \$\$.

Of the fourteen checks and withdrawals, five occurred between January 2, 20XX and April 10, 20XX when no organization activities occurred. Seven more checks and withdrawals occurred between November 14, 20XX and December 31, 20XX when no organization activities occurred.

In addition, there were fourteen additional expenditures made from the organization’s checking account which totaled \$. These were described in the organizations records as being “Professional Fees.” Eleven of these items occurred between January 5, 20XX and April 3, 20XX when no organization activities occurred. The remaining three expenditures occurred between December 5, 20XX and December 24, 20XX when no organization activities occurred. Further examination found that these were for repayment of loans, reimbursements for credit card purchases, rehab expenses for a house and to pay off a loan at a bank. No evidence was provided other than testimony that showed these payments were for the benefit of the organization or for any of the three activities that occurred during the year.

During the year under examination, five payments were made from the organization to PC, wife of the president. President indicated that the payments were for her services as Program Coordinator. Three of the payments were made in January 20XX and the two remaining payments were made in December, 20XX. No exempt activities occurred during January or December, 20XX. Nothing was seen during the examination which showed exactly what services PC provided as Program Coordinator.

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<b>Name of Taxpayer</b> ORG		<b>Year/Period Ended</b> December 31, 20XX

During April, 20XX two payments were made totaling \$. These were to CO-1 and CO-2. President stated that these were for shared expenses of the organization. No organization activities occurred during this month.

During 20XX President wrote checks or authorized electronic payments three times to make payments on his personal CO-3 account. The dates and amounts of these payments were February 21, 20XX in the amount of \$ July 18, 20XX in the amount of \$ and November 16, 20XX in the amount of \$. There was no organization activity in February or July of that year. During the examination no relationship between these payments and any exempt activity was ever determined.

The organization does not have an independent oversight board. President is in complete control of the organization and its expenditures. During the initial interview President stated that the organization officers were himself, PC (his wife), BM-1, and BM-2 and that during the year BM-3 replaced his wife.

ORG filed Form 990-EZ for the year ending December 31, 20XX. This return was received by the Internal Revenue Service on April 9, 20XX. On page one of this return, the organization showed a beginning balance of cash, savings, and investments of \$ on January 1, 20XX. The ending balance was shown as \$ on December 31, 20XX.

An examination of the bank account for this organization showed a negative beginning balance of \$( ) on January 1, 20XX and a balance of \$ on December 31, 20XX.

The information provided by the organization on its Form 990-EZ was clearly wrong and by significant amounts. The taxpayer never provided an explanation of the differences between the amounts of cash balances and revenues shown on the books and the amounts shown in the records.

The only books and records provided by the organization were nine pages of summary data listing the various sources of income and various expenses. Some of the information provided on these pages was duplicated. There were no records shown of assets and liabilities.

Form 990-EZ showed contributions and grants on Part 1, line 1 in the amount of \$ and gross revenue of \$ on Part 1, lines 6a and 6c. The records provided by the taxpayer showed "income" of \$, "sales" of \$ and transfers from CO-4 (a company owned by President) of \$. There was no correlation between the amounts shown on the records and the amounts reflected on the return. There were no sales of any type.

During the year under examination roughly \$ was received as donations from five donors. The organization received less than \$ from exempt function income.

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<b>Name of Taxpayer</b> ORG		<b>Year/Period Ended</b> December 31, 20XX

Of the \$ that came into the organization during 20XX, none could be shown to have been used for exempt purpose activities. Over \$ remained in the organization's checking account at December 31, 20XX.

**Law:**

**IRC Section 501(c)(3)** states "Corporations, and any community chest, fund or foundation organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, 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 or which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) and candidate for public office."

**Reg. 1.501(c)(3)-1(d)(1)(ii)** maintains that the organization must demonstrate that "it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled directly or indirectly by such private interests."

**IRC Section 6001** requires taxpayers to keep and maintain records adequate to determine whether or not an organization is liable for any tax covered by the Internal Revenue Code.

**Reg. 1.6001-1(a)** says that "Except as provided in paragraph (b) of this section, any person subject to tax under subtitle A of the Code, or any person required to file a return of information with respect to income, shall keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of gross income, deduction, credits, or other matters required to be shown by such person in any return of such tax or information."

**IRC Section 6033(a)** states in part "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..."

**Reg. 1.6033-2(i)(2)** states "Every organization which is exempt from tax, whether or not it is required to file an information return shall submit such additional information as may be required



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by the Internal Revenue Service for the purpose of inquiring into its exempt status and administering the provisions of subchapter F, chapter 1 of subtitle A of the Code, section 6033 and chapter 42 of subtitle D of the Code.”

**Rev. Rul. 59-95, 1959-1 C.B. 627** held that “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.

**Government’s Position:**

Inurement is a transaction between an exempt organization and an individual who is an insider. An insider, by virtue of his/her position within the organization, has the ability to influence or control application of the organization’s net earnings.

During the examination it was found that this organization does not have an independent oversight board and that President is in control of the activities and the expenditures. During the year under examination President withdrew organization funds from the bank and wrote checks to cash with no substantiation as to how the expenditures benefitted the organization. Twelve of these fourteen items in question occurred during periods when no exempt purpose activities occurred.

In addition, President made payments to his wife without any substantiation regarding exactly what services were performed by PC. His only testimony was that these payments were for services as a program coordinator with any elaboration as to what functions a program coordinator would perform. These payments occurred during times of the year when no program activities occurred.

Fourteen expenditures totaling more that \$ were made during the year for a variety of matters which could not be determined to be related to the exempt purposes of the organization. None of these expenditures occurred during a time period when exempt purpose activities occurred.

Two additional expenditures, described as utilities, were made totaling \$. Both of these payments were made during April, 20XX when no exempt purpose activities occurred.

There is little question that President and his wife received personal benefit from the checks cashed and the withdrawals from the organizations bank account. In addition, PC received benefit from the payments totaling \$ made to her. These payments were held out to be payments for services provided as a program coordinator but there was no evidence seen during the examination showing she had provided any services. In addition, the payments were made during January and December, 20XX when no exempt purpose activities occurred.

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Additional inurement occurred when President made three payments for his personal cell phone totaling \$. Two of the payments occurred in months when no organization activities occurred. Payment of personal expenses is a clear violation of IRC Section 501(c)(3) which states that no part of the net earnings shall inure to the benefit of any individual.

It was also clear during the examination that the taxpayer failed to keep records adequate to prepare a complete and accurate return in violation of IRC 6001. This is seen most obviously with the ending balance of net assets. The organization reported net assets of \$ when \$ was held in the organizations bank account. Rev. Rul. 59-95, 1959-1 C.B. 627 held that an organization that fails to keep records adequate to produce accurate returns failed to meet the requirements for continued exemption.

Further, more than \$ of expenditures directly benefited President. and PC from either direct payments, cash withdrawals, or payments of personal expenses.

**Conclusion:**

The cashed checks and withdrawals from the organization's bank account clearly reflect a personal benefit to President. In addition, payments made to PC were a benefit to her as well. Further, the payments of President cell phone bill resulted in another personal benefit. No evidence was seen that showed any of these payments were related to any of the organizations exempt activities.

It was also determined that the taxpayer failed to keep books and records as required by IRC Section 6001 and that the organization did not file a complete and accurate tax return.

The failure to keep and maintain adequate books and records is also a violation of IRC Section 6033. Rev. Rul. 59-95 holds that failure to keep and maintain such records may result in the revocation of the exempt status of an exempt organization.

Based on the facts and circumstances, ORG does not qualify for exemption under IRC 501(c)(3) and should be revoked effective January 1, 20XX because the President, President, and his wife each received a prohibited benefit. This inurement occurred in violation of IRC 501(c)(3) and Treasury Regulations 1.501(c)(3)-1(d)(1)(ii) and excludes the organization from exemption.

Please file US Corporate income tax return Form 1120 for the tax periods ending December 31, 20XX, December 31, 20XX, and December 31, 20XX.

Contributions to your organization are not deductible under IRC 170.

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
<b>Name of Taxpayer</b> ORG		Year/Period Ended December 31, 20XX

Please note that this is not a final report. The draft report is subject to review and modification by our Mandatory Review staff. You will receive a final report from Mandatory Review.