

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

501-03-00

EXEMPT AND
NON-EXEMPT ENTITIES
DIVISION

AUG 01 2012

Release Number: **201245022**

Release date: 11/9/2012

LEGEND

ORG – Organization name

XX – Date Address - address

Taxpayer Identification Number:

Person to Contact:

Employee Identification Number:

ORG

ADDRESS

Contact Numbers:

(Phone)

(Fax)

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 September 20, 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:

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))

In reviewing your records for 20XX through 20XX, we found inurement. You paid the personal expenses of your officers and did not maintain documentation to support the business purposes of the expenditures. You were not operated exclusively for exempt purposes.

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 years 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, *How to Appeal an IRS Decision on Tax-Exempt Status*
Form 6018, *Consent to Proposed Action - Section 7428*

Internal Revenue Service

Department of the Treasury
2525 Capitol Street #217
Fresno, CA 93721-2227

Date: July 25, 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,

Nanette M. Downing
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

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

LEGEND

ORG - Organization name XX - Date Address - address City - city
 State - state President - president DIR-1 - 1st DIR Vice President -
 vice president Treasurer - treasurer Secretary - secretary RA-1 &
 RA-2 - 1st & 2nd RA Video-1 & 2 - 1st & 2nd Video Book-1 = 1st book CO-1
 through CO-24 - 1st through 24th COMPANIES

Issues:

Issue 1 - Is ORG organized and operated exclusively for charitable, educational, and other exempt purposes as described in Internal Revenue Code section 501(c)(3)?

Issue 2 - Should ORG's tax exempt status be revoked due to the existence of inurement to President?

Issue 3 - Should ORG's tax exempt status be revoked for failure to maintain adequate records as required by Internal Revenue Code section 6033?

Facts:

History of the Organization

ORG (ORG) was incorporated in the State of State on December 16, 19XX. The specific purpose of the organization, as stated in its Articles of Incorporation, is to produce religious books, films, and video tapes for distribution to churches, schools, and religious groups and conduct seminars and retreats. ORG filed Form 1023, Application for Recognition of Exemption Under Section 501 (c)(3) of the Internal Revenue Code (Code) with the Internal Revenue Service (Service) on April 3, 19XX. The application is signed by President, President. The Service issued a letter of determination dated September 20, 20XX recognizing ORG as a tax exempt organization under Code section 501(c)(3). The letter stated that ORG was not a private foundation because it was an organization described in Code section 509(a)(1) and 170(b)(1)(A)(vi).

President and DIR-1 founded the organization. On Form 1023 President is listed as the President and DIR-1 is listed as the Financial Officer. In Bylaws provided on June 5, 19XX, DIR-1 is listed as the President and President is listed as a member of the Board of Directors.

In Part II, Activities and Operational Information, of Form 1023, ORG provided three numbered items to describe the activities it would conduct:

1. What are we going to produce? Do we have samples of our productions?

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We are enclosing one of our first videos, "Video-1". Also enclosed is a book, "Book-1" which was published in 19XX by President. This is the nature of films, videos and books we wish to publish and distribute. These were produced at our own expense.

2. How and where will these productions be distributed?

Distribution of these productions will be through friends, relatives, members of prayer and retreat groups. There are no direct sales; no advertising. All monies received will be from donations. There will be seminars & retreats for which we will solicit donations, but there will be no direct charge. The videos, books, candles, food, and anything else we offer will never be sold but offered for a suggested donation. The donations will always be based on cost and we will only ask that we can cover our basic costs. No person will be denied an item or service for lack of money. We look to the philanthropy of others to assist us in our mission.

3. How will these activities further our exempt purpose?

The publication of prayer books and the production of films and video tapes on the various components of Christian behavior, and making them available to everyone at little or no cost is the essence of our exempt purpose. This, we trust, will nurture and strengthen members to conduct weekly prayer meetings in response to invitations to hold prayer services in various homes in the area.

On Part III, Technical Requirements, of Form 1023, ORG stated that it received the following grants and provided the nature of the grant:

RA-1	\$	Building Remodeling
DIR-1	\$	Building Remodeling
RA-2	\$	Building Remodeling

On Schedule A, of Form 1023, ORG provided a brief history of the developments and the reasons for its creation:

On September 11, 19XX, an apparition, the image of a cross, appeared on a bathroom window at the home of DIR-1. DIR-1 called her mother to view the image- from that word spread and people flocked to the house at Address, City, State. Since that day people have come to that location to pray and worship.

Facilities

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In a letter dated May 26, 19XX, the Service requested clarification and operating details in order to make an exemption determination. ORG responded in a two page letter, with enclosures, dated June 5, 19XX signed by DIR-1. The letter stated that the facility at Address is owned by one of the Board Members and that the facility is made available at no cost to the organization. ORG also provided a list of five individuals comprising the Board of Directors and a list of four officers. President is listed as a Board Member, DIR-1 is listed as the President, and Treasurer, the first representative for the current examination, is listed as the Treasurer.

On June 15, 19XX the Service sent a letter to ORG requesting information on what amount the organization was going to pay for utilities, and how it intended to separate its funds from the President & DIR-1'. ORG' response, dated June 22, 19XX, stated that about 1/3 of ORG' funds were used to convert a portion of the home into a prayer room. Further, ORG will pay one half of the utilities each month for gas, electricity, water, gardening services and janitorial services. The average utilities were \$ a month; therefore, ORG was to reimburse the President & DIR-1 \$ a month. The letter also stated that income and expenses will be kept separate from that of the President & DIR-1 and that the President & DIR-1 would not handle any of ORG money because the Treasurer is a CPA, and a cosigner of the checks is one of the officers.

Activities

ORG' response to the Service, dated August 22, 20XX, stated that ORG had conducted monthly healing and prayer services since 19XX and had also included exercise and nutrition in its activities. The letter goes on to say that ORG conducts three exercise classes in three locations.

ORG' facility is located in DIR-1's residence. The house contains the prayer room which is approximately 660 square feet. The examining Agent did not observed anything in the prayer room preventing its use for personal reasons by the President & DIR-1. Since 20XX, ORG' primary activities consisted of one monthly gathering at its facility, and President said that he conducted free Fitness classes at nearby hospitals.

At the interview President explained that exercise classes are low impact routines directed at senior citizens. President founded the mind-body martial-arts fitness program he called Fitness. The 45 minute program consists of a series of breathing and stretching techniques using circular motions, knee bends, and weight lifting. Classes are free but some participants are asked to donate \$. The Fitness classes are not mentioned on Form 1023.

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President provided a copy of a DVD titled *President's FITNESS Mind Body Fitness Developing The Core PROGRAM 1* to support the exercise classes. The video was reviewed and it shows President demonstrating the Fitness methods. The back cover provides a brief description of FITNESS. The back cover also directs the reader to contact President for class schedule or to send inquiries to CO-1. The DVD itself shows *Copyright 20XX All Rights Reserved By President* and does not mention ORG.

In addition to the above activities, President provided a DVD copy of *Video-2* to support the type of video material ORG produced. The movie depicts a small town being over taken by drug dealers and corrupt government officials. The drug dealers and officials combine forces to methodically have all the residents of the small town become drug users. Their plan is spoiled by a pastor and other good Samaritans. President is one of the actors in the movie. The DVD cover states that CO-2 Corporation presents the film and shows President as the producer. The DVD itself shows *Copyright 20XX CO-2 Corp All Rights Reserved* and does not mention ORG.

Officers

The 20XX Form 990EZ lists four officers. DIR-1 and President are the President and Treasurer respectively, and Vice President is listed as the vice president. President could not provide contact information for Vice President because they lost touch a few years back. Secretary is listed as the Secretary. Secretary was not present during the interview but was contacted at a later date. He said he has been involved with ORG since its inception but had no knowledge of ORG' financial matters. He did not recall the last time the Board convened but was in regular contact with President. The 20XX Form 990EZ does not reflect compensation for President and DIR-1, and neither was issued a form W-2 or F1099.

President provided a copy of Board minutes for only one meeting that took place on January 7, 20XX. Those Minutes did not indicate other Board member involvement, other than President and DIR-1. According to the minutes, ORG business was not discussed.

Financial Information

President said that he receives the donations, deposits the donations, balances the check book, and writes the checks. President said that DIR-1 and Treasurer can also sign checks. Check copies were requested for 20XX and the subsequent years, but they were not provided.

ORG provided February through December bank statements for 20XX for its one bank account. The deposits and credits were tabulated and showed that ORG deposited \$ in

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Professional fees
Occupancy
Depreciation
DVD Duplication
Food for events
Honorarium
Information Tech
Insurance
Repairs & Maint
State & Local taxes
Transportation
Total

ORG reported \$ in revenues and \$ in expenses on its 20XX Form 990EZ. President was issued IDR 3, dated September 17, 20XX, requesting the bank statements, copies of paid checks, and supporting documentation for the 20XX year. President provided copies of bank statements and handwritten financial statements for the 20XX year, but did not provide source documents for any of the expenses. The bank statements were reviewed and the deposits and expenses tabulated. ORG deposited a total of \$ and paid a total of \$. The expenses are categorized as follows:

20XX	
Gasoline	Lawn Service
Car Payments	Donation
Car Repairs	Tax Service
Travel	House Payments
DMV License	Home Insurance
Car insurance	Honorarium
Food Potluck	CO-16
Food Special Occa	CO-17
Meeting Care Fac	Utilities
Meeting Restaurant	CO-18
Loan to Care Fac	DVD Editing
Supplies	CO-19
CO-21	CO-20
CO-22	Electrical Service
CO-23	Install Cooking Grill
CO-24	Install Water Heater
Toiletries	Install Shed
Cleaning Service	Sewer Repair
Special Food Cash	
Sub total	Sub total
Sub total	
Sub total	

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Total

Law:

Code section 501 (c)(3) exempts from federal income tax organizations organized and operated exclusively for charitable, educational, and other exempt purposes, provided that no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

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

Regulations section 1.501(c)(3)-1(c)(1) provides that an organization will not be regarded as operated exclusively for exempt purposes if more than an insubstantial part of its activities is not in furtherance of exempt purposes.

Regulation section 1.501(c)(3)-1.(d)(1)(ii) provides that 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.

Code section 6033(a)(1) provides, except as provided in Code section 6033(a)(2), every organization exempt from tax under Code section 501(a) shall file an annual return, stating specifically the items of gross income, receipts and disbursements, and such other information for the purposes of carrying out the internal revenue laws as the Secretary may by forms or regulations prescribe, and 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.

Regulation section 1.6001-1(a) in conjunction with section 1.6001-1(c) provide that every organization exempt from tax under Code section 501(a) and subject to the tax imposed by Code section 511 on its unrelated business income must keep such permanent books or accounts 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. Such organization shall also keep such books and records as are required to substantiate the information required by Code section 6033.

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Regulation section 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.

Regulation section 1.6033-1(h)(2) provides that every organization which has established its right to exemption from tax, whether or not it is required to file an annual return of information, shall submit such additional information as may be required by the district director for the purpose of enabling him to inquire further into its exempt status and to administer the provisions of subchapter F, Code section 501 and Code 6033.

Rev. Rul. 59-95, 1959-1 C.B. 627, concerns an exempt organization that was requested to produce a financial statement and statement of its operations for a certain year. However, its records were so incomplete that the organization 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 provisions of Code 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 grounds that the organization has not established that it is observing the conditions required for the continuation of exempt status.

Taxpayer's Position:

The taxpayer previously did not agree with the proposed revocation, but subsequently verbally agreed to the proposed revocation.

Government's Position:

Issue 1 - Is ORG organized and operated exclusively for charitable, educational, and other exempt purposes as described in Code section 501 (c)(3)?

ORG stated on Form 1023 that it was going to produce Christian based videos and books. The videos and books were to be distributed to friends, relatives, and the general public. The videos and books were to be made available at no cost or at minimal cost. At some point President began to provide fitness classes.

The *Video-2* DVD does not mention ORG. The President & DIR-1 were unable to demonstrate that the production of the video and the video itself furthered ORG' tax exempt purpose. The President & DIR-1 were unable to demonstrate that the video was distributed at no cost or minimal cost. The President & DIR-1 did not provide any support to show that ORG was involved in the video production. The President & DIR-1 were unable to show that President's involvement was not a private venture undertaken by

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President. The rights to the *Video-2* DVD are held by CO-2. ORG did not provide any book samples.

The *FITNESS* DVD depicts exercise instructions directed toward senior citizens. ORG is not mentioned in the DVD or on the DVD cover. The video does not have a religious aspect and the production of exercise videos is not mentioned on Form 1023. The reader is directed to contact President or CO-1 for schedule information. The DVD itself shows *Copyright 20XX All Rights Reserved By President*. President is using ORG funds to pay the expenses he incurs to conduct the Fitness classes. President is using ORG funds to promote a fitness program he invented and holds the rights to. Regardless of the fact that the classes are provided at no cost to the participant, the manner in which the activity is carried on is no different than a marketing strategy, that is provide free samples to consumers with the hope the product will find a market.

ORG' history provided on Form 1023, Schedule A, states that DIR-1 witnessed an apparition in 19XX. Word of the apparition spread and people began to gather at the home to pray and worship. The gatherings, as described in Schedule A, further ORG' tax exempt purpose. However, the President & DIR-1 were unable to demonstrate that the current gatherings are as described on Form 1023. The President & DIR-1 were unable to show that the gatherings have not been over taken by a social quality to host friends and or relatives. The President & DIR-1 use ORG funds to purchase food for the gatherings, but providing food at their gatherings is not mentioned in Form 1023 and does not further the ORG' tax exempt purpose. Although it is expected that the gathering will inevitably have a social aspect, ORG' tax exempt purpose is to permit the gathering of individual to witness the apparition, not to provide food for the gatherings.

The President & DIR-1 did not demonstrate that ORG is operated exclusively for charitable, educational, or other exempt purposes as described in Code section 501(c)(3).

Issue 2 - Do ORG's net earning inure to the benefit of President as prohibited in Code section 501 (c)(3) and should ORG's tax exempt status be revoked due to the existence of inurement?

As stated in the *Facts* portion of this report, the President & DIR-1 did not provide source documents for any of the expenses paid with ORG funds. The explanations provided by President indicate that ORG funds are used to pay for personal expenses. The explanations also show that the President & DIR-1 received reimbursement amounts for hosting ORG in their home in excess of the amount they stated would be paid to gain tax exempt status. No support was provided to demonstrate how an increase was calculated or approved. The automobile fuel, loan, insurance, and repair payments made with ORG funds to pay for the expenses incurred by President while providing the Fitness classes do

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not further ORG's tax exempt purpose. The expenses are personal in nature and are incurred by President in the course of marketing his Fitness classes.

The amount of inurement is calculated by subtracting the annual reimbursement amount ORG was to pay the President & DIR-1 from the amount actually paid. The calculated annual reimbursement amount is calculated by multiplying the monthly reimbursement amount by 12 (\$ X 12 = \$). The amount of inurement is calculated as follows:

20XX	
Mortgage payments	Fuel Purchase
Utilities	CO-8
CO-3	CO-9
Gardener	CO-10
Honorarium	CO-11
Supplies	Checks to cash
CO-4	Air travel
CO-5	CO-12
CO-7	CO-13
CO-6	CO-14
Car Payment	CO-15
Car Insurance	Miscellaneous
Sub total	Sub total
Sub total	Total
Sub total	Allocation
Total	Inurement

20XX	
Professional fees	
Occupancy	
Depreciation	
DVD Duplication	
Food for events	
Honorarium	
Information Tech	
Insurance	
Repairs & Maint	
State & Local taxes	
Transportation	
Total	
Allocation	
Inurement	

20XX	
Gasoline	Lawn Service
Car Payments	Donation
Car Repairs	Tax Service
Travel	House Payments
DMV License	Home Insurance
Car insurance	Honorarium
Food Potluck	CO-16
Food Special Occa	CO-17
Meeting Care Fac	Utilities
Meeting	
Restaurant	CO-18
Loan to Care Fac	DVD Editing
Supplies	CO-19
CO-21	CO-20
CO-22	Electrical Service

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CO-23	Install Cooking Grill
CO-24	Install Water Heater
Toiletries	Install Shed
Cleaning Service	Sewer Repair
Special Food Cash _____	
Sub total	Sub total
Sub total	Total
Sub total _____	Allocation
Total	Inurement

The amount of inurement in the 20XX year is \$, in the 20XX year is \$, and in the 20XX year is \$. The amount of inurement represents %, %, and % of total reported revenues for the 20XX, 20XX, and 20XX years respectively.

Substantially all of the ORG' net earnings inure to the benefit of the President & DIR-1 and therefore revocation of ORG' tax exempt status is warranted.

Issue 3 – Did ORG maintain adequate records as required by Code section 6033 and should ORG's tax exempt status be revoked for failure to maintain adequate records?

ORG did not provide source documents to show that any of the expenses paid furthered its tax exempt purpose for 20XX. ORG did not provide source documents or bank statements for the 20XX year. ORG did not provide source documents to show that any of the expenses paid in 20XX furthered its tax exempt purpose. ORG did not provide an expense reimbursement allocation method to show the amount it was to reimburse the President & DIR-1 for hosting ORG in their home. ORG did not provide support to show how the expense reimbursement amount was calculated, and who approved it, that resulted in a significant increased from the amount the President & DIR-1 stated would be paid on Form 1023.

ORG was unable to provide support for its revenues. Support for its revenues was requested and only hand written notes were provided, but no source documents were presented. The support request was made to confirm that ORG is publicly supported. The notes provided indicate that ORG is not a publicly supported organization. ORG failed to provide source documents for expenses for 20XX, 20XX, and 20XX. The lack of records alone is sufficient to revoke an organization's tax exempt status and coupled with the other issues identified in the examination, ORG's exemption should be revoked.

Conclusion:

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The President & DIR-1 did not demonstrate that ORG is operated exclusively for charitable, educational, or other exempt purposes as described in Code section 501(c)(3); ORG' net earning inure to the benefit of President and DIR-1 as prohibited in Code section 501(c)(3); and ORG did not maintain adequate records as required by Code section 6033. ORG' tax exempt status should be revoked for all of the above-explained reasons.