



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

TE/GE: EO Examination

1100 Commerce Street

Dallas, Texas 75242

501.03-00

**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

Date: February 28, 2013

Release Number: **201351029**

Release Date: 12/20/2013

LEGEND

ORG – Organization name

XX – Date Address - address

ORG

ADDRESS

Employer Identification Number:

Person to Contact/ID Number:

Contact Numbers:

(Phone)

(Fax)

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

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 dated January 15, 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:

IRC 501(c)(3) of the Internal Revenue Code exempts from Federal income tax: 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 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...

Treasury Regulation Section 1.501(c)(3)-1(d)(1)(iii) provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest.

You have not established that you are operated exclusively for exempt purposes described in section 501(c)(3) of the Code. Specifically, you have not shown that a substantial part of your activities does not serve the private interest of your officers and other individuals. Additionally, you have not demonstrated that no part of your net earnings inures to the benefit of private shareholders or individuals.

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code. You are required to file Federal income tax returns on Form 1120. Those returns should be filed with the appropriate Service Center.

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

If you decide to contest this determination, 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 Claims Court or the District Court of the United States 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 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 court 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 you have to file a petition in a United States court. The Taxpayer Advocate can, however see a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance. If you prefer, you may contact your local Taxpayer Advocate at:

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

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

Thank you for your cooperation.

Sincerely yours,

Nanette M. Downing
Director, EO Examinations

Enclosure:
Publication 892



Department of the Treasury
Internal Revenue Service
Tax Exempt and Government Entities Division
450 Golden Gate Avenue, MS 7401
San Francisco, CA 94102-3412

ORG
ADDRESS

Date:
January 3, 2013
Taxpayer Identification Number:

Form:

Tax year(s) ended:

Person to contact / ID number:

Contact numbers:

Manager's name / ID number:

Manager's contact number:

Response due date:

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:

Internal Revenue Service
~~Office of the Taxpayer Advocate~~

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 December 31, 20XX December 31, 20XX December 31, 20XX

LEGEND

ORG - Organization name XX - Date EIN - ein Address - address City - city State - state Program - program
 Event -1 through Event-9 - 1st through 9th EVENT CEO - ceo Secretary - secretary BM-1 through BM-7 - 1st through 7th
 BM CO-1 through CO-21 - 1st through 21st COMPANIES

Issues

- 1) Does the organization operate primarily for exempt purposes?
- 2) Does the organization's net income inure to the benefit of the organization founder and board chair?

Facts

Outline

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 - iv) CO-3
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 - c) BM-2
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 - c) DINNER
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10) Accrued Liability

Background

The organization currently under audit is ORG (subsequently ORG), a State nonprofit corporation, EIN EIN. ORG is exempt under section 501(a) of the Internal Revenue Code (IRC) as an organization described in IRC section 501(c)(3). The current TE/GE examination is for the years ending December 31, 20XX, 20XX, 20XX, and 20XX. All details below, unless otherwise noted, are based on facts learned concerning the year ending December 31, 20XX. The taxpayer has not responded to Information Document Requests regarding subsequent years.

ORG filed their articles of incorporation with the State Secretary of State in August 20XX. ORG received its final determination letter in January 20XX, with retroactive exemption as of August 20XX. The final determination letter found the organization exempt under IRC 501(c)(3) with IRC 509(a)(2) foundation classification.

ORG had the following filing requirements:

- o Form 990
- o Form 944

The Form 990 for 20XX and 20XX was received by the extended due date. The 20XX Form 990 was extended to August 15, 20XX and was received November 22, 20XX. The service center did not assess penalties or interest. The organization has never had employees, and has never filed the Form 944. During the audit, examining agent removed the Form 944 filing requirement.

Purpose

The purpose noted in the articles of incorporation was:

Provide ORG training and mentorship to youth to optimize chances of career and educational success.

The 20XX executive summary provided in response to IDR #4 states:

Our mission is to create and develop marketable youth who are academically proficient by providing CO-2 education, targeted career exposure, and solutions-based collaboration utilizing 21st century technology. Our vision is to become the largest community of successful youth in the world.

ORG's purpose was to apply the organization founder CEO's business philosophies to youth to help them be successful. The organization defined youth as between ages 16 and 24. ORG did not define "youth" on the Form 1023. In CEO's promotion of himself and his self-improvement philosophies, he often describes the difficult circumstances in which he grew up. The implication is that his ORG program is for disadvantaged youth, but this is not a component of the organization's purpose.

Form 990

The mission described on the 20XX Form 990 is:

Equipping youth to be successful by delivering real life information and tools to youth, parents, and concerned citizens through school assemblies, events, academy programs, and a highly informative website while maintaining a strong bond that appeals to youth of all ages

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Subsequent year Forms 990 indicate the following mission:

Our mission is to grow the ORG community through interactive summits, virtual learning, and a strong social network dedicated to life skills and success intelligence while maintaining partnerships that create awareness and provide opportunities for the youth we serve.

The stated program service accomplishments on the 20XX, 20XX, and 20XX Forms 990 were:

PROGRAM – ORG conducted ten sessions consisting of orientation, eight workshops, and a final workshop that served young men and women from the eleventh grade through the age of 25.

The Leadership Development Series focused on training a core group of leaders who would serve as future “PROGRAM” trainers with in the communities served.

The organization's Power of Attorney (POA) later stated that the Leadership Development Series did not occur in 20XX. The program service revenue reported on the Form 990 was actually for adult ORG workshops. ORG indicated in Schedule O several programming changes in 20XX. They changed the program focus from large community events to the PROGRAM; they eliminated fees for the program; and they changed its focus “to build a virtual environment that could touch the masses in which it is still building.”.

The 20XX Form 990 indicated a new program service accomplishment:

The ORG social network was designed to create an environment for youth to pursue information, skills, and opportunities that will help them become successful. Instead of creating another online way to chat with the masses and/or look for companionship, we will create an environment with a precise focus on delivering knowledge and opportunities conducive for success. This will create a success engine that will ignite a fire in many youth to see and believe that success is possible for everyone if the right effort is made (expense \$\$).

The Forms 990 showed the following income and expenses:

	20XX	20XX	20XX	20XX
fundraising events				
donation income				
adult ORG workshop revenue				
total revenue				
professional fees – CO-2				
meals				
other expenses				
total expenses				
net income (loss)				

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The Forms 990 for 20XX showed the following assets and liabilities:

	20XX	20XX	20XX	20XX
assets				
liabilities				
net assets				

The liabilities were substantially all payable to CO-3, Inc. and CO-2 (subsequently CO-2). In 20XX, over 90% of the total liability was payable to these entities.

Application for Tax Exempt Status

ORG submitted its Form 1023 Application for Recognition of Exemption in August 20XX. Its planned purpose was "to foster knowledge that will assist youth and young adults in developing positive skills that will strengthen educational performance and improve lives." Its planned activities were:

- 1) Virtual academies – linking schools with ORG instructors using simulcast video and interactive software
- 2) Community events – to teach youth and young adults about the importance of ORG through presentations by business and educational professionals
- 3) Learning academy – seminars, mentoring, and youth development activities
- 4) School partnerships – offering ORG curriculum at schools and colleges

On the application, ORG reported a liability of \$\$ at the end of 20XX payable to two companies owned by the organization founder, CEO. Reports provided during the examination showed a liability of \$\$ payable to CO-2 and \$\$ to CO-2 at the end of 20XX. A total liability of \$\$ was payable to these entities by the time the application was filed.

During the application process, CEO submitted a request for expedited processing of the Form 1023 because ORG was in danger of losing pledges from sponsors. He included copies of four letters from potential sponsors. Two of these letters were regarding pledges from other companies owned by CEO: \$\$ from CO-5 and \$\$ from his restaurant, CO-6's. The IRS granted the request for expedited processing October 20XX.

In addition to this correspondence, the exempt organizations determinations specialist requested additional information from ORG in October, November, and December 20XX. This correspondence was primarily about potential conflicts of interest regarding management contracts with insiders. ORG was selected for audit due to the following these concerns raised during the application process:

- o Management contracts with insiders
- o Related for-profit entity
- o Agreements negotiated during development
- o Validity of information contained in the application

Audit Interviews

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The TE/GE audit interviews were at Address, City, State. This office was home to ORG and the for-profit companies owned by CEO. In the year under audit, CO-2 let ORG use this office space free of charge.

The audit dates and participants were:

- o November 15, 20XX with the organization's Power of Attorney
- o December 12, 20XX with the POA and Executive Director BM-4
- o August 15, 20XX with the POA, CEO, BM-1, and Secretary, CEO's executive assistant.

The area manager and examining agent met with the taxpayer and representative at the TE/GE offices at address on two occasions:

- November 27, 20XX with the POA
- December 13, 20XX with the POA, CEO, BM-1, Secretary, and BM-2 (via Skype)

Interactions with the taxpayers and their representative were pleasant. Responses to IDRs were sometimes delinquent, inaccurate, and lacked detail to paint a clear picture of ORG activities. At the two final meetings at the TE/GE offices, the parties discussed the case issues and the necessary steps to close the case on a mutually acceptable basis. At the time of the issuance of the final Form 886-A Revenue Agent Report, the organization had not responded to IDR #8 (submitted November 6, 20XX) and IDR #9 (December 11, 20XX) requesting documentation of activities in 20XX, 20XX, and 20XX.

Key Players

CEO

CEO was the founder of ORG and the organization's board chair in all years under audit. He owned and operated a collection of companies under the appellation CO-12. CO-12 was incorporated in the state of City in April 20XX. It is an LLC with a Form 1120 filing requirement. CEO was the president and CEO of at least two of his companies, CO-1 and CO-2. CO-12 promoted CEO as a visionary, a motivator, and a personality. The themes of business management, self-improvement, and financial management connected several of his companies. On his website and in speaking engagements, CEO used his personal story of emerging from troubled childhood to become a successful businessperson to promote CO-12. CEO's collection of businesses included the following:

- o ORG is a non-profit started by CEO for the purposes of helping youth aged 16 to 24 become successful individuals. The footer on the 20XX ORG website listed the following supporters with links: CO-1, CO-7, CO-8.CO-8, CO-9, CO-6's, CO-2 I, CO-10, and CO-5.
- o CO-7 - In an audit interview, CEO described "CO-7" as a mental philosophy or leadership concept which he used in a variety of ways. In speaking events, he used it to inspire and motivate listeners: "You are the CEO of the business of running your life." The current CO-12 website, describes CO-7 as an "
- o CO-2 (now CO-2 Solutions, Inc.) is a leadership philosophy developed by CEO. On the current CO-12 website, this business sells workshops, books, DVDs, consulting, coaching, and certification training in CO-2 business management philosophy. CEO's book is for sale on the CO-2 website and the website promotes CEO as a speaker. In the years under audit, CO-2 also contracted with ORG to provide services. See *Management Contracts with Insiders*, below.
- o CO-3, Inc. focuses on building businesses using CO-2. In a 20XX web capture, CO-2 said that successful companies must appoint their customers as their CEOs, utilizing the CO-7 and the CO-2

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business philosophies. The 20XX website also promoted CEO's book, the CO-12 website, the CO-2 philosophy, and several of the CO-12 companies. In the years under audit, CO-2 also contracted with ORG to provide services. See *Management Contracts with Insiders*, below.

- o CO-3 is an online financial management service. A 20XX web capture says: "With CO-4 System, there's not only the opportunity to manage your finances in a more organized and systematic way, but there's also the opportunity to start your own business and get paid for referring CO-3 to the people you know. We offer this opportunity through our CO-7 CO-11."
- o CO-1 is a salon. The website featured links to all of the CO-12 companies. The current ORG website features testimonials of ORG participants, several of whom are CO-9 stylists.
- o Other companies included in the CO-12 collection were CO-13, CO-8.CO-8, CO-17, CO-6, CO-5, CO-14, CO-15, and CO-16.

BM-1

BM-1 was ORG's executive director and as such filled the role of president. The meeting minutes provided show that CEO and the three board members elected BM-1 to serve as executive director. The board repeated this nomination and election annually in the meeting minutes provided. Correspondence during the application process clarified that BM-1 is not a director; the POA stated during audit correspondence that as executive director he was an elected officer of the organization. In an audit interview, CEO reported that in 20XX BM-1 worked 40 hours per week for ORG for no compensation. The POA also stated that there was no contract with BM-1 and no compensation paid. The Form 1023 explained that BM-1 was a consultant to CO-2 and a project proposal provided during the audit showed that BM-1 is a senior instructor for CO-2.

BM-2

BM-2 was ORG's secretary and treasurer. As with BM-1, the three board members and CEO elected him. BM-2 was also the CFO of CO-2. BM-2 was not compensated by ORG.

BM-3

BM-3 is a CPA and serves as ORG's appointed representative for this audit. The POA prepared the Forms 990 for all years under audit. BM-3 did not fully understand the organization's activities and did not take care to ensure the accuracy of responses to the Information Document Requests. Wherever possible and necessary, examining agent used the best information available.

Board

Development during the Application Process

The exempt organizations specialist corresponded with ORG during the exemption application process to ensure that the organization was not controlled by CO-2, that the board was comprised of individuals without a financial interest in CO-2, and that CO-2 were compensated not excessively and in accordance with IRC 501(c)(3).

Meeting minutes included with the original application, indicated that the board was comprised of three CO-2 employees: CEO, his executive assistant Secretary, and . The original bylaws, included with the application, designate CO-2 as the organization's sole "member" possessing the power to appoint

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and remove at will all directors. This equated to control of ORG by CEO, the sole shareholder of CO-2. The initial application also showed CEO's planned compensation to be \$\$.

In response to October 20XX correspondence from the exempt organizations specialist, ORG removed CEO's compensation to demonstrate that no private interest was served. To ensure the board represented the broad interests of the community, CO-2 elected three new directors to the board: BM-5, BM-6, and BM-7. Finally, ORG explained how compensation rates for CO-2 were determined using comparability data and how CEO and BM-1 did not participate in the votes for the contracts.

In response to November 20XX correspondence from the exempt organizations specialist, ORG amended the bylaws to remove CO-2 as the organization's sole member. At the direction of the exempt organizations specialist, Secretary and BM-3 submitted statements resigning from the board to ensure that the board was comprised of no more than 49% interested persons. CEO remained on the board. BM-5, BM-6, and BM-7 all signed a statement committing to take an active part in the operation of ORG. ORG also described in more detail how compensation for CO-2 were determined. ORG also clarified which board members approved the consulting contracts with CO-2.

In response to December 20XX correspondence, ORG further clarified about approval of and compensation rates paid to CO-2.

Audit Year Board

During the all years under audit, the Forms 990 and meeting minutes show the following board members. None received compensation.

- o CEO Chairman of the Board
- o BM-5 Director
- o BM-6 Director
- o BM-7 Director
- o BM-3 Secretary and Treasurer

In response to the November 20XX request for clarification, the taxpayer stated that BM-1 was the organization's chief executive officer (later executive director) and not a board director.

The POA described the three directors as "a broad range of professionals from the East Bay community who are committed to educating and developing youth. These directors have worked with the founder in various professional and social capacities." As a part of the application process, the taxpayer submitted the resumes of the board members, which generally confirms their interest in relevant issues.

Conflict of Interest Policy

The intent of ORG's conflict of interest policy was to protect the organization's interests. The following provisions were incorporated into the organization's bylaws prior to the organization's application for exemption.

- a. An interested person must disclose the existence of a financial interest and be given an opportunity to disclose all material facts to the directors and members of committees with governing board delegated powers considering the proposed transaction or arrangement
- b. After disclosure of the financial interest and all material facts, and after discussion with the interested person, the interested person will leave the meeting while the determination of a

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conflict of interest will be discussed and voted on. The remaining board will decide if one exists.

- c. The interested person may make a presentation regarding the proposed transaction. They will leave during discussion and vote on the possible conflict of interest. If appropriate, the chairperson will appoint a disinterested party to investigate alternatives. The board will decide if they can find, with reasonable effort, a more advantageous transaction with a non-interested person. If none is reasonably available, the board will vote if the transaction is in the organization's best interest.
- d. If the board has reasonable cause to believe a member has failed to disclose an actual or possible conflict of interest, the interested person will be given an opportunity to explain their failure to disclose. After hearing the response and investigating further as warranted, the board will determine if the interested person failed to disclose a conflict of interest, and will take appropriate disciplinary action.

Ultimately, "A financial interest is not necessarily a conflict of interest. ... a person who has a financial interest may have a conflict of interest *only if the appropriate governing board or committee decides that a conflict of interest exists.*"

Board Meetings

In all years under audit, ORG held an annual and a special meeting in August each year. All board members, officers, and BM-1 were present at both meetings and signed each set of meeting minutes. At the 20XX annual meeting, the following items were resolved:

- 1) The CEO would continue to serve as chairman of the board and BM-5, BM-6, and BM-7 would continue to serve as board members.
- 2) BM-1 was elected to serve as CEO by the board members.
- 3) The bylaws were amended so that the required number of directors was reduced to three; the title of the chief executive officer was changed to executive director; and the payments of money by ORG must be signed by at least one person authorized by the corporation.
- 4) *"The Board of Directors stated that the question before the meeting was whether to renew Professional Services Agreement with CO-2, Inc. and to determine if any conflict of interest exist[s] due to interested person, CEO, association with CO-2, Inc. and if this agreement is in the best interest of the corporation.
Upon Motion duly made, seconded, and carried unanimously by the vote of members of the Board (excluding Chairman and Officers), it was:
RESOLVED, that the professional Services Agreements with CO-2, Inc. does not represent a conflict of interest and is in the best interest of the corporation and is therefore approved."*

The annual meetings in 20XX, 20XX, and 20XX were identical in regards to numbers one, two, and four, above.

In conjunction with the annual meeting, each year all of the board members, officers, and BM-1 signed an "Annual Statement" confirming their belief in the work of the organization and committing to take an active part in carrying out the mission of ORG. This is likely in continued response to a request during the determinations process by the exempt organizations specialist that the organization submit signed and dated statements by the board saying that they will take an active part in the operation of ORG.

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The purpose of the special meetings held each August was to review and approve the Form 990. The board did not produce an annual report as mandated by the bylaws; in lieu of this, they utilized the Form 990.

In response to IDR #7, the POA stated that the ORG board and BM-1 held an annual meeting at the beginning of each calendar year "to discuss the direction(s) the non-profit will take during the respective twelve month period." The POA continued, "And while BM-1 has significant influence on how mission is conducted, the Board of Directors has the ultimate decision making power in how to promote and spread the message of helping underprivileged individuals, especially younger people." As shown above, there is no evidence of this type of meeting recorded in meeting minutes provided.

The board did not review ORG's activities or the conduct of the management companies. The POA stated, "ORG management these organizations services by the provision of the services agreement. No additional documentation was required [sic]." CO-2 do not provide reports to the board to inform it of ORG's programming or status. In 20XX, CO-2 each provided a single invoice to ORG as documentation.

Management Contracts with Insiders

ORG had management contracts with CO-2 for the provision of all services necessary to operate the organization. Without CO-2, ORG does not exist. CEO started all three entities. All three operate out of the same office with the same officers, CEO and BM-2.

CEO signed both contracts on behalf of CO-2 and BM-1 signed both for ORG. The effective date of the CO-2 contract is November 27, 20XX and the effective date of the CO-2 contract is August 1, 20XX.

CO-3

Meeting minutes do not show that the board discussed approval of this contract in accordance with the conflict of interest policy.

The management contract states that CO-2 would furnish ORG with qualified personnel to perform and deliver professional consulting services. The work would be done in a workmanlike fashion and in accordance with specifications provided to CO-2, would be of professional quality, and would not be disrupted due to unavailability of employees. The attached fee schedule provided a little detail on the contracted professional services.

- Accounting Services
 - Develop framework for accounting controls
 - Train QuickBooks systems
 - Develop vendor agreements
 - Prepare financial reports and tax information
- Marketing Services
 - Research and identify business and government agencies with strong educational alliances
 - Advise and deliver event & tour plans
 - Coordinate event collateral and mailers
 - Consult on program introductions and presentations
- Fundraising/Grant Consulting

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- Consult on corporate sponsorship
- Create and deliver foundation and grant tactical plans and agreements for target agencies
- Consult on managing foundation and grants agreements
- Create and deliver internal policies/controls to meet regulatory compliance (state & federal)
- Information technology
 - Identify IT and audio visual needs
 - Establish and maintain servers for internet based programs
 - Deliver IT support for events and tours
 - Produce public service video and audio productions
- Administrative Support
 - Provide and maintain office supplies
 - Provide copier-document production services for educational and event material
 - Provide postage and mail support

Fees due would be based on fair market value, which the contract showed to be \$ per hour.

CO-2

The board approved this contract in the 20XX annual meeting minutes.

The management contract states that CO-2 would furnish ORG with qualified personnel to perform and deliver the following professional marketing services: "design, procure, market, and sale [sic] products". Future professional services and deliverables could be determined. The work would be done in a workmanlike fashion and in accordance with specifications provided to CO-2, would be of professional quality, and would not be disrupted due to unavailability of employees. The attached fee schedule provided detail on CO-2's duties.

- Product Development
 - Research and identify products to retail
 - Create client brand and image design
 - Create product designs using client's logo
 - Deliver products designs and samples
- Product Procurement
 - Research vendors to procure product
 - Research pricing/cost strategies
 - Consult with clients on procurement cost
 - Deliver products meeting cost strategies
 - Coordinate on inventory controls systems (lien [sic] management systems)
- Product Marketing
 - Design and maintain website for client
 - Create E-commerce platforms on-line for client
 - Establish retail agreements to accept credit card payments
 - Create and deliver mailer/email blast campaigns to promote products

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- **Product Sales**
 - Consult with client on product pricing
 - Coordinate on product fulfillment (ordering & delivering)
 - Coordinate on sales promotions for events
 - Coordinate on sales promotions strategies and goals

A review of the organization website and other promotional material indicated the intent to sell ORG branded clothing as a component of the organization's efforts to build "a movement." The other details on the fee schedule showed that CO-2 was responsible for ORG's website design and maintenance.

The original exemption application contained a contract that stated that CO-2 would provide services in exchange for 50% of net profit. The exempt organizations specialist informed ORG that this constituted inurement. The final contract stated that invoices would be based on the cost of goods sold and variable cost.

Both Contracts Provide:

- ORG would maintain the ownership of all work performed and product generated by the consultant under the contract.
- ORG agreed to a provision barring the solicitation of the contractor's employees.
- The contractors were reimbursable for travel expenses if invoiced with supporting documentation.
- Invoices with supporting documentation would be submitted on the 10th of each month and paid by ORG within 30 days.
- ORG could terminate the contract with out cause and either party may terminate if the other materially defaults in its performance of duties. Otherwise, the contract remains in effect. Upon termination, ORG would receive a final invoice.

Comparability Data

Examining agent requested copies of the comparability data used by ORG when they decided to sign the contracts with CO-2:

- Compensation paid for similar work by similar organizations
- Compensation surveys of at least three similar organizations for the same geographic area
- Copies of bids to work for ORG provided by other entities
- A schedule of fees charged by CO-2 to other clients

The POA did not provide sufficient documentation to show that comparability data was use to determine CO-2 compensation rates. The POA provided a national survey of salaries for consultants and managers. The contracts were not competitively bid. The POA did not provide a fee schedule of rates typically charged by CO-2. The POA provided project *proposals* by CO-2 and CO-2. CO-2's Forms 1120 indicate that the entities have sources of other revenue, but the sources and rates cannot be determined based on the information provided.

Invoicing

In 20XX, CO-2 each invoiced ORG only once. CO-2 invoiced ORG on February 16, 20XX for \$ for expenses associated with the fundraising dinner event. CO-2 invoiced ORG on March 31, 20XX for \$ for "credit card pymt for social network (ORG)." The POA provided a timesheet as supporting documentation for the CO-2 invoice; there was no supporting documentation for the CO-2 invoice.

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Activities

The proposed activities cited in the Form 1023 were:

- o Virtual academies to link schools with the ORG program via video stream and interactive software
- o Community events to inform youth and adults about the importance of acquiring ORG
- o A learning academy consisting of seminars, mentoring, and youth development activities
- o School partnerships to offer ORG curriculum on campuses

Examining agent had difficulty compiling a list of ORG activities supported by documentation. In response to IDR #7, the POA submitted a list of seven activities tied to substantiation provided on a disk in response to IDR #6. The following are activities as listed by them with elaboration drawn from interviews and other documentation provided during the audit.

1) *Adult Workshops*
IDR #7

ORG stated that they developed these workshops for "young adults that were entering the workforce and professionals that are looking for personal and professional development opportunities." The courses were provided on a bi-monthly basis, lasted 2.5 hours, averaged 15 participants, and cost \$ per participant. ORG did not define bi-monthly or state the number of workshops. ORG initiated this project, created the curriculum, and conducted the workshops. CO-2 created all of the PowerPoint presentations and the student workbook.

Additional Research

During interview #3, CEO explained that for ORG to be effective, they needed to instill the value of ORG in the student, the parent, and the teacher. CEO said they invited the parents of participating kids to come to adult ORG workshops, but the workshops were open to anyone who was interested. He estimated that 50% of the attendees were parents/guardians. He also stated that they did several workshops in 20XX. No invitations or enrollment forms were provided.

A website capture dated May 20XX indicates that the purpose of this programming is not to buttress ORG's primary purpose.

We would like to encourage all Adults to have an open mind and take the time to look through the information provided within this website. ORG™ is NOT just for youth; rather, we also offer a variety of courses to adults that will assist them in gaining the necessary skills they need to be successful in every area of their lives. Whether you are trying to improve as a parent, professional, or in any personal area of your life, ORG™ can assist you.

ORG provided copies of 14 sessions/presentations. The POA stated that no video footage was available to substantiate the workshops. He also said that CO-7 and courses were the only programs offered in 20XX.

CO-2 did not invoice ORG for this work in 20XX. The GL showed no corresponding adult ORG income. The most likely GL item is "Program service fees" totaling \$. Per the GL, these courses cost \$ each; the POA had previously reported that the cost was \$ and \$. Under this account were 62 entries dated 12/XX/20XX with a memo of "Cash management" and 14 entries dated 12/XX/20XX with a memo of "Financial management." These titles do not match the presentations provided in response to IDR #6. On

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first look at this account, BM-1 wasn't sure what these entries were. He then called them "single class webinars." This was the only program revenue on the GL and was reported on the F990.

The GL provides the best estimate of participation: 78 individuals participated in two workshops resulting in income of \$.

2) *ORG Programs & Presentations*
IDR #7

The taxpayer included ORG programs and presentations as an exempt purpose activity. The taxpayer stated the organization "provided many of the programs and services, as well as personal development & life skills training to this community organization." ORG indicated that each activity/event lasted between two and a half and five hours. The PowerPoint slides and documents included on the CD and the description provided indicate the following:

- o 4 motivational presentations/events/trainings on personal awareness and positive thinking
- o 1 "appreciation event" which appears to be selling points and requests to support of CEO's nine companies
- o CO-18 agenda and presentation, promoting ORG to the audience
- o Presentation at the CO-20 National meeting saying that the church has partnered with ORG
- o Brainstorming notes on a play proposal for kids
- o Handouts for a day-long program for high school seniors
- o A flyer advertising two "youth forum" 1.5 hour workshops

One document is CO-1 branded. Four items are co-branded with _____ branding, an entity never before mentioned during the audit. Several items are in line with ORG's exempt activity; motivational trainings, agendas for relevant programming, flyers, and brainstorming. The rest are requests for support for CEO's businesses and pitching the ORG program.

ORG estimated the following participation:

- o Workshops – average 150
- o Training – 100
- o Youth Address – 1,000+
- o Youth Forums – average 150
- o Event – 1,000+

ORG created the curriculum/content and hosted the activities and events, while CO-2 created all of the PowerPoint presentation templates. ORG provided copies of several presentations on a disk. The organization stated that pictures of the "ORG Appreciation Event" were available on FaceBook.

Additional Research

The POA and taxpayer did not describe this activity at any other time during the audit. CO-19 and CO-20 are not identified in these supporting documents.

Earlier in the audit, ORG provided a "20XX Timeline of Programs and Services" which included "Youth & Young Adult Summit" as one of the items. Several potentially related 'youth items' – a forum, an address, a workshop – were included with the substantiation later provided. This may correlate with the CO-20/CO-19 presentations.

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A review of CO-2 invoices dating back to late 20XX showed no charges for CO-20, CO-19, or Youth & Young Adult Summit. The GL shows that no community organization compensated ORG for 'providing programs and services.'

Based on the information provided, it is impossible to discern what the extent of ORG's activities were and how it furthered its exempt purpose. It appears that CO-20/CO-19 invited ORG to participate in events by speaking and presenting motivational topics. An estimate of attendance based on the numbers provided by ORG would be:

- o 6-7 workshops/trainings of 100-150 each
- o "appreciation" event and a youth address with attendance of 1,000 each

3) *DINNER*

IDR #7

The benefit dinner, a fundraising and appreciation event, was an oft-cited activity during 20XX. ORG stated that they "hosted a fundraising dinner which they recognized some of [their] community supporters, highlighted [their] student's successes, and informed the community of upcoming efforts." The taxpayer stated that over 400 individuals attended the event and that tickets cost \$ or \$ for students and seniors. The target audience was "beneficiaries of our program, our current following, and our sponsors and supporters."

CO-2 created all collateral and organized, promoted, recorded media, and managed the event under the professional services agreement. ORG provided copies of advertising posters and brochures, donation slips, ticket order forms, solicitation letters to potential sponsors, event agenda, and a copy of the event presentation describing the program and its accomplishments to date.

Additional Research

The POA stated that ORG made no invitations or solicitations to the public for the event. Family and friends of 20XX CO-7 participants were "welcomed." CEO stated that attendees came from all the organizations and churches they had worked with, not just the prior participants. The POA previously stated that tickets cost \$ each. The GL shows approximately 300 individuals paying \$ each.

The taxpayer indicated that video of the event was available on FaceBook. A video of CEO speaking during the event was available on YouTube. In his speech, CEO promoted the program. There was no view of the audience.

ORG correctly reported the dinner income of \$ on the F990. The \$ invoice from CO-2 for this work was the only CO-2 invoice to the organization in the year under audit. The invoice included the line "event promotional services" for \$. The POA explained that this was to promote the event on Comcast Cable and for the creation of 30- and 60- second commercials placed on CO-8, posters, brochures, event program, event planning, and AV support (highlight video, recording of event, hosting of promotional materials online). The dinner is responsible for approximately half of both the 20XX income (\$) and expenses (\$).

4) *Speaking Engagements*

IDR #7

The taxpayer cited speaking engagements as one of its exempt purpose activities. The taxpayer stated that ORG was invited to participate as keynote speaker at six community events in 20XX and that they

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hosted two community appreciation events of their own. The six events they spoke at targeted youth in primary school, secondary school, and college. The six events they spoke at as a guest were:

- Event-1
- Event-2
- Event-3
- EVENT-4
- Event-5
- Event-6

ORG claimed that 500-1,000 attendees were at each event. ORG provided a copy of a promotion for the program as evidence of its speaking engagements.

CO-2 created the speaking engagement package for each event and CO-2 was responsible for the media production.

Additional Research

The POA had previously confirmed that there had been four speaking engagements in 20XX:

- Event-5
- Event-7
- Event-8
- Event-9

A review of the relevant videos available on YouTube showed the speeches were all by CEO. In total, there were five videos of CEO speaking engagements to varying size audiences in varying locations. No dates or descriptions are included on the YouTube listings. It was impossible to tie the video of the speeches to the events cited above.

ORG reported no income from the speaking engagements on the F990 or GL. There are no letters of appreciation to CEO or ORG for doing these speaking events.

CO-2 had no speaking engagement invoices dating back to early 20XX. CO-2 had some media production charges for unspecified projects on invoices dating to early 20XX. Media production charges for CO-2 should likely be contemporaneous with the date of the event.

The four to six speaking engagements likely did occur, although the size and nature of the events cannot be substantiated. CEO has an active career that includes public speaking engagements. It is impossible to separate CEO's personal career from the speaking engagement activities of ORG.

5) *Website*

IDR #7

As substantiation of its exempt activities, ORG provided copies of "website files." Most could not be opened, but they appeared to be images of logos and other content to be included on the ORG website. Also included were four PowerPoint presentations containing drafts of the website pages promoting the ORG's positive thinking and personal awareness philosophy. ORG claimed the purpose of the website was to serve their current community and to attract additional community members to their work. The taxpayer stated that they created all of the content and that CO-2 designed and developed the website. They stated project took 100 days.

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Additional Research

The taxpayer stated that they revamped the entire website from the original one developed in 20XX. Earlier in the audit, the POA provided printouts from the ORG website to explain its activities. Video streaming and reality-based content provided academic development, career exposure, and life changing information. Most of the material seemed to be motivational-speaking type.

The only invoice from CO-2 in the year under audit is for \$ for the social network. Web captures from 20XX do not show evidence of the social network on the ORG website.

6) *The Campaign*
IDR #7

ORG partnered with (celebrity) on a bay area tour to promote his Campaign. The Campaign organized the activity and ORG (CEO) participated as a speaker. The tour included visits to three middle and high schools in the cities of City and City. The taxpayer stated that the tour targeted youth who showed leadership potential in their local communities. The taxpayer claimed they spoke to over 2,000 students in total over the course of one day.

ORG provided as substantiation a copy of the project budget (charging the Campaign \$ for its work), an agreement on how the facilitators from the two groups will work together, and a presentation on the "5 Phases" for implementation of the program.

The POA included as substantiation a copy of the regular ORG program outline and application, and a CO-2-branded presentation on the 5 Phases, including slides on seven of CEO's other companies. The line between the tax-exempt organization and the for-profit companies started by CEO is not always clear.

CO-2 was responsible for media production and created the " " proposal.

Additional Research

In response to an IDR, the POA agreed with the following statement describing the program: "Work was done to create a partnership with other program developers, but this program did not come to fruition." The POA stated that they created enrollment forms and a fee schedule for the program as well. Because the program did not come to fruition, none of this was implemented. There are no corresponding invoices from CO-2 dating back to January 1, 20XX.

A review of video footage showed a "pitch" speech at the with a tiny crowd and motivational speeches by CEO and others at CO-19, CO-20, and at CO-21. The video combined highlights of all the speeches, so it was difficult to discern exactly what happened at each. Crowds of kids range from 20-500 and appear more like high school assemblies than targeted programming.

7) *CO-7*
IDR #7

The taxpayer stated that ORG conducted the program for 2.5 hours per week for 10 weeks with youth aged 16-24. ORG sought out 30 students, and actually served 27. ORG provided copies of nine workshop presentations, activities, and games used during the presentations. ORG created the curriculum and conducted the workshops while CO-2 created the PowerPoint presentations, student workbook templates,

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and all activities for the program. CO-2 was responsible for media production. The taxpayer stated that a highlight video was available on FaceBook and "a full playlist of the program" was available on YouTube.

Additional Research

The POA and the taxpayer stated several times that 20XX was the only year that they conducted the program. BM-1 said that the organization had spent some time developing the program to be used with The Campaign. When that fell through, they decided to continue with it on their own. CEO also stated that "CO-7" is more of a philosophy than a program. It influences much of ORG's activity.

The POA provided a copy of the roster of 27 students. There were no enrollment forms. BM-1 said that tuition was originally \$, but that they would only charge this as necessary in the future. In 20XX, there was no charge to participate.

The POA initially stated that in the year under audit, the CO-7 program was a free series of 8-13 workshops and provided 12-workshop syllabus. ORG did not have any "homework" or other items completed by participants as evidence of youth involvement. ORG did not have any flyers or posters advertising the program to share. Most participants were attracted through public speaking engagements.

ORG syllabus:

- 1) orientation
- 2) personal success
- 3) success thinking
- 4) committed to success
- 5) success planning
- 6) decision for success
- 7) relationship for success
- 8) success communication
- 9) living success

ORG stated that Leadership Program clips on YouTube are from the CO-7 program. Previously they had stated that they did not have the Leadership Program in the year under audit. The Leadership Program was intended for graduates of the CO-7 program; the material is likely very similar. The clips show personal development workshops with 20-30 participants at two venues. This material is undated and unlabeled on YouTube.

ORG stated that no charges on the single invoice from CO-2 in 20XX were for expenses related to the CO-7 program. There are no CO-2 invoices for CO-7 dating back to January 1, 20XX. CO-2 submitted an invoice dated December 15, 20XX for \$ with the project name "foundation curriculum." This may be for CO-7 development, although ORG stated that they created the curriculum and CO-2 created the collateral.

Activities Summary

The overall theme of the workshops, speaking engagements, and presentations is motivational and self-improvement. In CEO's speeches, he often utilizes his CO-7 philosophy, encouraging people to take control of their lives, because "you are the CEO of the business of running your life." ORG's workshops take participants through a self-assessment of their strengths and their needs, and lay out the steps to self-improvement, outlining the basis of setting goals, forming good relationships, and so on.

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Several other activities came up over the course of the audit but were not presented on ORG's final list of activities. One of the best developed, but apparently not enacted activities, was selling ORG-branded clothing to promote the "movement". It was suggested that "youth would wear ORG paraphernalia" regularly in a proposed program. The POA suggested that retail sales was an expected income stream contributing to future profitability. No income from sales of such items was reported on the Form 990 or recorded on the GL for 20XX.

The social network was another potentially exempt purpose activity not listed as an activity. The purpose of the social network was to engage kids, parents, and teachers using popular, modern technology. During the audit, CEO made a brief demonstration of the current version of the social network. Web captures from 20XX do not show that it was operational in 20XX. The CO-2 invoice for 20XX says "social network" on it. It is unclear what the status of this activity was in 20XX.

The actual activities can be grouped this way:

- o *Fundraising* - the fundraising dinner
- o *Marketing* - CEO's speaking engagements and speaking at other organizations' events in order to promote the ORG program and CEO and his business philosophies
- o *Exempt purpose activities* - the CO-7 program run once with 27 participants and the ORG website giving information about the organization to the community; the adult self-improvement workshops

The actual activities had little consistency with what ORG proposed during the determination process. Only the exempt purposes activities were consistent, and they comprised a small portion of overall activities. Marketing events may have coincided with community events. The community speaking events ultimately served to draw participants into the CO-7 and ORG philosophies. The details and the inconsistency of the activities indicated there is not a comprehensive plan to become "the largest community of successful youth in the world"

The activities of CEO's companies and ORG had significant overlap. The absence of income and expenses for many cited activities failed to support that the activity occurred or indicated that another company may have recorded the activity on its books. CEO's speaking resume on the CO-12 website includes seven speaking engagements from 20XX about ORG, including the

Accrued Liability

The GL showed a liability at the end of 20XX of \$ to CO-2 and \$ to CO-2. The POA provided invoices substantiating these liabilities. The following charts are compiled primarily from the GL accounts, and contain relevant information from project time sheets and the interviews to paint a more complete picture of ORG's activities.

CO-3 Accounts Payable				
date	notes	payment	invoice	balance due
08/31/XX	rent, parking, other occupancy			
10/01/XX	rent, parking, other occupancy			
10/01/XX				
10/01/XX				
11/29/XX	advance			
12/31/XX	professional fees - other			
12/31/XX				

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01/01/XX	08/16/XX	event,
01/01/XX	09/16/XX	information session event,
01/01/XX	09/30/XX	personal awareness event,
01/01/XX		discipline event, 11/01/XX;
01/01/XX		tour
01/01/XX		positive thinking event, 10/14/XX;
01/01/XX		tour
01/01/XX		
01/01/XX		rent, parking, other occupancy
01/01/XX		rent, parking, other occupancy
01/01/XX		
01/01/XX		
01/01/XX		
01/01/XX		legal fees, contracted AV
01/01/XX		broadcasting services
01/01/XX		
01/13/XX		<u>ORG, Positive Relationships</u> event: executive, accounting, marketing, event promotional, research & development, audio visual & IT, administrative, mileage, document reproduction, cost of refreshments and creating overall facility look & feel, cost of facility
05/16/XX		<u>Gala event for Academy:</u> executive & leadership, accounting, marketing, event promotional, audio visual & IT, administrative, mileage, document reproduction, cost of facility (\$\$)
<i>August 20XX - Form 1023 Application for Recognition of Exemption signed by CEO and received by IRS.</i>		
12/XX/XX		<u>luncheon event:</u> executive & leadership, accounting, marketing, event promotional, audio visual & IT, administrative, mileage, document reproduction, cost of facility (\$)
12/31/XX		
12/31/XX		photography and billboard rental
12/31/XX		
01/23/XX		teleservices transfer

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02/16/XX	fundraising event: executive & leadership, accounting, marketing, event promotional, audio & IT, administrative, mileage, document reproduction, cost of facility (\$)
03/XX/XX	
12/01/	teleservices transfer

The primary expenses incurred to CO-2 were for events, including at least one fundraiser, and ranged in cost from \$to \$ each. None of the expenses were for curriculum development or programming with youth.

CO-2 Accounts Payable				
date	notes	payment	invoice	balance due
09/21/XX	supplies			
09/22/XX	supplies (summed eight line items)			
10/XX/XX	supplies (summed 16 line items)			
10/14/XX	supplies			
10/16/XX	supplies			
10/18/XX	supplies			
11/XX/XX	supplies			
11/XX/XX	supplies			
11/XX/XX	supplies			
11/22/XX	supplies			
01/01/XX	<u>Only Believe:</u> brainstormed product concept, created content outline, coordinated media recording, media recording and editing (\$), product package design, product pricing, marketing strategy, added to ecommerce site, added to fulfillment operations, mileage, supplies and equipment (\$), product reproduction			
01/29/XX				
03/01/XX	<u>Organize Your Life:</u> brainstormed product concept, created content outline, coordinated media recording, media recording and editing, product package design, product pricing, added to fulfillment operations, added to ecommerce site, document reproduction, supplies & equipment, marketing strategy			

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<p>03/01/XX Audio Book: brainstormed product concept, created content outline, coordinated media recording, media recording and editing, product package design, product pricing, marketing strategy, product fulfillment, added to ecommerce site, mileage, document reproduction</p> <p style="text-align: center;"><i>August 20XX - Form 1023 Application for Recognition of Exemption signed by CEO and received by IRS.</i></p> <p>12/15/XX Foundation Curriculum: brainstormed product concept (\$), created content outline (\$), coordinated media recording, media recording and editing, product package design, product pricing, marketing strategy, document reproduction (\$)</p> <p>12/21/XX</p> <p>03/31/XX marketing, credit card payment for ORG social network</p> <p>06/05/XX</p> <p>08/25/XX</p> <p>09/XX/XX</p> <p>09/15/XX</p> <p>11/25/XX</p>		

Most of the expenses incurred to CO-2 were for product/media development and production. The Only Believe and Organize Your Life events didn't relate to any CO-2 invoices. An audio book was never mentioned during the audit, although CEO's book, _____, is for sale on several of his companies' websites. The December 15, 20XX foundation curriculum invoice could be for program curriculum development. The 20XX social network invoice could be related to the organizations exempt purpose.

Law

IRC 501(c)(3) says:

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 of 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) any candidate for public office.

Treasury Regulation 1.501(c)(3)-(1)(a) says:

Organizational and operational tests. (1) In order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more

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of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Treasury Regulation 1.501(c)(3)-(1)(c) says:

Operational test – (1) Primary activities. 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 section 53.4942(b)-1(a)(2)(ii) defines "primarily" as at least 50%. Treasury Regulation section 53.4942(b)-1(c) defines "substantially all" as 85% or more. Therefore "insubstantial" means less than 15%.

In Revue Ruling 76-152, 1976-1 C.B. 151, a group of art patrons formed an organization to promote community understanding of modern art trends. The organization selected modern art works of local artists for exhibit at its gallery, which was open to the public, and for possible sale. If an artwork was sold, the gallery retained a commission of ten percent and paid the remainder to the artist. The ruling states:

If the purposes or operations of an organization are such that private individuals who are not members of a charitable class receive other than an insubstantial or indirect economic benefit there from, such activities are deemed repugnant to the idea of an exclusively public charitable purpose... This result is the same, moreover, even if the purposes and activities of the organization would be charitable were it not for the element of private benefit.

On the facts of the instant proposal we believe a prohibited direct economic benefit is conferred on the individual artists by the gallery's sale and rental of the art works.[T]he sale activity provides the artist with a direct monetary benefit and serves to enhance his artistic career. This benefit cannot be dismissed as being merely incidental to the organization's other exempt purposes and activities as it is substantial by any measure.

In Church by Mail, Inc. v. Commissioner, T.C. Memo, 1984-349, aff'd, 765 F.2d 1387 (9th Cir. 1985), two evangelists formed a "church" whose principle activity was mailing out holy water, prayer cloths, and solicitations for donations. They also started a direct mail company. The church contracted with the direct mail company and the direct mail company purchased computer services from a data processing company whose stock was owned by the two evangelists. All three entities also employed the evangelists and their families. The church operated at a loss because of the expense of the direct mail campaigns and was only able to keep operating because of loans and advances from the direct mail company. The court stated:

The critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the Church.

The Court determined that the church was not entitled to exemption because it was operated for the substantial nonexempt purpose of enriching the evangelists and their families. The church cancelled its contract with the direct mail company, but the Court held that this did not stop the flow of funds to the evangelists. Formal legal control is not necessary if the facts demonstrate dual control of the two entities.

Inurement

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Treasury Regulation 1.501(c)(3)-(1)(c)(2) provides: "Distribution of earnings. 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)(ii), provides that:

An organization is not organized or operated exclusively for [exempt purposes] 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(a)-1(c) defines a private shareholder as "...persons having a personal and private interest in the activities of the organization." Inurement refers to the non-incidental diversion of assets, which are supposed to be dedicated to charitable purposes, to an insider of the organization. See American Campaign Academy v. Commissioner, 92 T.C. 1053, 1068 (1989).

Treasury Regulation 1.501(c)(3)-1(f)(2)(ii) states:

Determination of whether revocation of tax-exempt status is appropriate when section 4958 excise taxes also apply. In determining whether to continue to recognize the tax-exempt status of an applicable tax-exempt organization (as defined in section 4958(e) and § 53.4958-2) described in section 501(c)(3) that engages in one or more excess benefit transactions (as defined in section 4958(c) and § 53.4958-4) 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;*
- (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) and § 53.4958-7), or the organization has made good faith efforts to seek correction from the disqualified person(s) who benefited from the excess benefit transaction.*

In Housing Pioneers, Inc. v. Commissioner, 58 F.3d 401 (9th Cir. 1995) the organization's purpose was to provide affordable housing for low income and handicapped persons. The organization entered into an agreement with a for-profit partnership to participate in a project whereby the for-profit's property would be exempt from property tax. As part of the agreement, the for-profit loaned money to the exempt to buy an interest in and become a general partner. Part of the property tax savings was to go to the general partnership to keep rents low and part to the exempt organization for its charitable purposes. The court ruled that even though the tax reductions were to be used exclusively to make rents affordable, private inurement was present. Federal income tax advantages and property tax reductions resulted in inurement at least indirectly to the benefit of the non-exempt partners (two of whom were insiders with respect to the

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exempt entity) because their partnerships were relieved of maintaining rents at a level sufficient to cover operating expenses that would otherwise have to be paid out of partnership capital.

Record keeping and reporting requirements

Section 6001 of the Code provides that every person liable for any tax imposed by the code, or for the collection thereof, shall keep adequate records as the Secretary of the Treasury or his delegate may from time to time prescribe.

Section 1.6001-1(c) of the Treasury Regulations provides that every organization exempt from tax under section 501(a) of the Code and subject to the tax imposed by 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, receipts and disbursements. Such organization shall also keep such books and records as are required to substantiate the information required by section 6033.

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

IRC section 6033(a)(1) states that, except as provided, every organization exempt from tax under IRC 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.

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 Service for the purpose of inquiring into its exempt status and administering the provisions of subchapter F (i.e., IRC section 501 and following), chapter 1 of subtitle A of the Code, IRC section 6033, and chapter 42 of subtitle D of the Code.

An organization's failure or inability to file required information returns or otherwise to comply with the provisions of IRC section 6033 and the regulations which implement it, may result in the termination of the organization's exempt status based on the grounds that the organization has not established that it is observing the conditions that are required for the continuation of its exempt status. These conditions require the filing of a complete and accurate annual information return (and other required federal tax forms) and the retention of records sufficient to determine whether the organization is operated for the purposes for which it was granted tax-exempt status and to determine its liability for any unrelated business income tax.

Taxpayer Position

The taxpayer's position is unknown at this time.

Government Position

1) Does the organization operate primarily for exempt purposes?

IRC 501(c)(3) exempts corporations...organized and operated *exclusively* for charitable...or educational purposes. An organization is not organized or operated *exclusively* for one or more exempt purposes

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unless it serves a public rather than a private interest. The burden is on the organization to establish that it is not organized and operated for the benefit of private interests such as the founder or their family, shareholders of the organization, or persons controlled, directly or indirectly, by private interests. The organization's activities must be broad enough in scope to confer a public benefit versus serving to benefit only a few. Serving the public is a basic tenet of the law of charity whose purpose is to ensure that those who constitute the "public" benefit equally.

A review of details of the relationship between ORG and CO-2 showed that ORG served a private interest and was not operated exclusively for charitable purposes. An analysis of each of ORG's activities and the actual results of each activity shows both a qualitative and a quantitative private benefit to CEO, CEO's companies, and BM-2.

Characteristics of Private Benefit Relationships

Control

CEO owned and operated several closely tied businesses, including ORG, under the umbrella entity CO-12. BM-2 was an officer of ORG and at least two of CEO's businesses, including CO-2. The original exemption application for ORG showed CEO and BM-2's intent to maintain control of ORG via a board comprised solely of CO-2. The application also showed original intended compensation to CEO of \$. The control that CEO and BM-2 had over the entities and the entities' closeness allowed them to use ORG to benefit themselves and the for-profit businesses.

The minutes of the 20XX annual board meeting were brief and written in legal language. They attempted to convey a sense of a well-run organization that adhered to the letter of the law. The minutes failed to show any involvement of the board in the mission of the organization.

While no more than 49% of the board was comprised of interested persons, the independence of the board was not certain. The board exercised little control over ORG activities. The POA provided conflicting information about board involvement. Initially, the POA stated that meeting minutes did not record any discussion of program function, duties, or responsibilities because there were no designated committees. Rather, BM-1 handled the majority of duties. Later, the POA stated that the board held an annual meeting with BM-1 to discuss the direction(s) ORG would take during the next year. The POA indicated that the board made final decisions regarding ORG programming with significant input by BM-1. The meeting minutes do not reflect this.

Conflict of Interest Policy

The board composition included CEO and BM-2, which ensured that members of CO-2 and CO-2 were present at all board meetings and involved in planning ORG's operations. As noted above, the conflict of interest policy required that interested persons not be present for discussions of and vote on transactions that might result in a conflict of interest. Meeting minutes do not indicate adherence to the policy or include the content of the discussion and reasons for determining a conflict of interest did not exist.

Fundamentally, the conflict of interest policy stated that a conflict of interest existed only if the board determined that there was one. Regardless of the independence of the board, this effectively negated any protections this policy provided to ORG.

Management Contract with Insiders

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Several elements of the management contractors lent themselves to serving private interests. The management contract did not provide for any specific deliverables for the board to monitor. The management companies essentially were ORG. Without the CO-2, ORG would not have existed.

ORG did not seek competitive bids for services. It is unclear if CO-2 had ever before run a nonprofit similar to ORG. The net loss of \$ resulting from the fundraiser did not indicate that CO-2 was good at fundraising and called into question the true intent of the fundraiser.

Additional elements of the management contracts were common to private benefit relationships. The contract was open-ended, indefinitely benefitting BM-2, CEO, and his companies. ORG agreed to a contractual provision barring the solicitation of the contractor's employees.

ORG Activities and Beneficiaries
-Fundraising

The fundraising dinner event reached 350 individuals who ORG solicited via public speaking events and through former participants. Benefit to attendees of this event was purely incidental. Video footage shows the continued promotion of ORG's self-improvement programming. The purpose of this fundraising event was to increase the liability to CO-2, to raise funds to pay down this liability, and to promote CEO's speaking career and business philosophies. The event raised \$ but cost \$ payable to CO-2. In 20XX, the net accounts payable to CO-2 increased to \$ due. The true beneficiaries were CO-2, its owner CEO, and its CFO BM-2.

Marketing

Benefit to attendees at speeches and presentations was incidental. CEO used the opportunities to promote ORG and his CO-7 philosophy, and to demonstrate and promote his own speaking ability. The Campaign in particular was an opportunity to work with a celebrity to gain access to schools and a broader basis of support. These outreach events resulted in a larger pool of potential donors to invite to fundraising events. Income from these speaking engagements, if any, was not recorded on the ORG GL; it may have been recorded on CO-12' GL. The true beneficiaries were the debt holders, CO-2, BM-2, and CEO and his personal enterprise.

Exempt Purpose Programming

Nearly all organizations must have a website to reach their constituencies and to inform the public of their activities. ORG hired CO-2 to create and manage the website. In the primary year under audit, ORG incurred a \$ liability to CO-2 for work on the social network/website.

ORG's CO-7 program was a version of CEO's CO-7 company targeted at youth aged 16 to 24. While there was an educational component to the self-improvement workshops, the true intent was to gain marketing access to schools, churches, and community spaces. This access allowed CEO to grow the base of financial support and to expose people to his CO-7 "mental philosophy" and his personal brand. Likewise, Adult ORG exposed participants to CEO's business and life philosophies and potentially to his other for-profit businesses, such as CO-18. Some benefited from participating in ORG's CO-7 and Adult ORG programs, but CEO's companies also benefitted from the exposure.

Qualitative Benefit

The private benefit to CEO, CO-2, and CO-2 was not incidental or merely a necessary byproduct of ORG's programming. Certainly, ORG had the right to contract for management expertise; however, it had the

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option to hire experienced employees or use volunteer staff. ORG could have conducted its activities without conferring benefit on CEO, his companies, or BM-2.

ORG's activities generally promoted CEO and his collection of for-profit businesses. The CO-7 philosophy served as the basis of ORG and of CEO's CO-7 business. It is difficult to draw a line between the two activities. Part of the intent of the ORG program was to get individuals enrolled mentally in the philosophy. The speaking engagements, events, and ORG participants provided opportunities to expose new customers to CEO's other businesses. The ORG speaking engagements were inseparable from CEO's career as a speaker. CO-2's relationship with ORG gave the companies access to ORG's charitable receipts.

Quantitative Benefit

The nature of the activities and ORG's method of documenting its activities make it very difficult to quantify the public versus private benefit. Based on estimates provided by ORG and a review of substantiation provided, the following quantifiables are present:

	ORG participants	shared participants	duration	income	expense
Adult ORG workshops	78		2 days		
CO-19 programs and presentations		2813	?		
fundraiser dinner	350		1 evening		
CEO speaking engagements		2500	4-6 hrs total		
Website/social network			100 days		
Campaign		20XX	1 day		
CO-7 program	27		2.5 hrs/wk, 9 wks		
total	455	7313			

While ORG claims to have affected over 7,000 individuals, most of this is by participating as a speaker at events hosted by other organizations. ORG has only directly affected 27 youth and 78 adults through its exempt purpose programming. This is only 1% of all individuals the organization claims to have touched.

No income or expenses from activities with questionable exempt purposes, such as CEO's speaking engagements, were recorded on ORG's GL. Because of the interrelatedness of all of CEO's businesses, the exempt nature of any activity might be claimed by ORG, while the income or expense could be recorded on another company's books. The absence of income for CEO's speaking engagements indicates that CO-12 might have collected payment. CEO's speaking resume on CO-12 website includes several speaking engagements about ORG.

The income and expense analysis of the fundraising event is revealing. ORG paid CO-2 \$ to manage the fundraiser. ORG received \$ in donations from the event, resulting in a net loss of \$. CEO stated that the fundraiser was their first large event and that they learned from the experience. A review of past invoices

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indicates that the fundraiser was not the first large event that ORG hired CO-2 to manage (e.g.). The true purpose of the event was not to fundraise for ORG, but to increase liabilities to CO-2 and to raise funds to make payments to CO-2.

The relationship with ORG gives CEO and his companies access to ORG's tax-exempt status and its contributors. This provides an alternate revenue stream to keep his companies in business.

While some members of the public may have benefitted from ORG's activities, the benefit to CEO, CO-2, CO-2, and BM-2 negates that benefit. The accounts payable to CO-2 and CO-2 are substantial. At the close of 20XX, ORG owed \$ to CO-2. ORG does have some charitable potential, but its activities taken as a whole are not exclusively in furtherance of exempt purposes. There is a substantial nonexempt purpose of providing benefit to CEO, CO-2, and CO-2. Any benefit to youth is secondary and incidental to ORG's activities.

Does the ORG's net income inure to the benefit of the founder and board chair?

IRC § 501(c)(3) exempts corporations organized and operated exclusively for charitable or educational purposes when *no part of the net earnings inures* to the benefit of any private shareholder or individual. 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. Inurement is concerned with the direct transfer of income or provision of services unrelated to exempt purposes. A private shareholder or individual is considered an "insider" with respect to the exempt organization

ORG's net income inures to the benefit of CEO through payments to CO-2 in excess of the value received. CEO is the sole shareholder of CO-2. In 20XX, the only payment to CO-2 was greater than the value services provided by CO-2. The fundraising event ORG contracted with CO-2 to manage cost \$ yet raised only \$ resulting in a net loss for the organization.

The value received by ORG in terms of the number of youth served is far smaller than the value of \$ owed to CO-2 at the end of 20XX.

CO-12, CO-2, and CO-2 are structured so closely that ORG's income inures to the benefit of CEO. Donations made to ORG are transferred to CO-2 to pay down accrued liabilities. Although the payments are for operational costs of the organization, donations to ORG relieve CO-2 from covering their own operating expenses. Especially in the current weak economy, this income keeps CEO's businesses operational. It is in CEO's interests to keep ORG operational, and to expand and extend CO-2's commercial activities through the organization.

Conclusion

As a result of the examination of the Forms 990 filed by ORG for periods ending December 31, 20XX; December 31, 20XX; December 31, 20XX; and December 31, 20XX, the examining agent has determined that ORG no longer qualifies as an exempt organization described in the IRC section 501(c)(3) for the following reasons:

Issue #1

The organization is not operated primarily for exempt purposes. It is operated primarily for the purposes of funneling money to the founder's for profit companies, the for profit companies' officers BM-2 and CEO, and to promote the founder's speaking career.

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Issue #2

Income to the organization inures to the benefit of the organization founder through payments to his for profit companies. The organization's exempt status should be revoked as of January 1, 20XX.