



DEPARTMENT OF THE TREASURY

Internal Revenue Service  
TE/GE EO Examinations  
1100 Commerce Street MC 4920 DAL  
Dallas, TX 75242

TAX EXEMPT AND  
GOVERNMENT  
ENTITIES DIVISION

Date: **OCTOBER 09, 2018**

Number: **202149012**  
Release Date: 12/10/2021

Person to Contact: Identification  
Number:  
Telephone Number:  
In Reply Refer to:

UIL. 501.03-00

LAST DATE FOR FILING A PETITION  
THE TAX COURT:

**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 (IRC). Our favorable determination letter to you dated December 20, 20XX, is hereby revoked and you are no longer exempt under section 501(a), as an organization described in section 501(c)(3) of the IRC, effective January 1, 20XX.

Our adverse determination was made for the following reasons:

You have not established that you are operated exclusively for an exempt purpose or that you have been engaged primarily in activities that accomplish one or more exempt purposes as required by IRC 501(c)(3) and Treas. Reg. section 1.501(c)(3)-1(c)(I).

You have not established that no part of your net earnings inures to the benefit of any private shareholders or individuals within the meaning of IRC 501(c)(3).

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

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

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

If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Court of Federal Claims or the District Court of the United States for the District of Columbia before the 91<sup>st</sup> day after the

date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment. You may write to the courts at the following addresses:

United States Tax Court  
400 Second Street, NW  
Washington, DC 20217

US Court of Federal Claims  
717 Madison Place, NW  
Washington, DC 20005

U. S. District Court for the District of Columbia  
333 Constitution Ave., N.W.  
Washington, DC 20001

The Taxpayer Advocate Services (TAS) is an independent organization within the IRS that can help protect your taxpayer rights. We can offer you help if your tax problem is causing a hardship, or you've tried but haven't been able to resolve your problem with the IRS. If you qualify for our assistance, which is always free, we will do everything possible to help you. Visit [taxpayeradvocate.irs.gov](http://taxpayeradvocate.irs.gov) or call 1-877-777-4778.

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

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

Sincerely yours,

A handwritten signature in black ink that reads "Maria Hooke". The signature is written in a cursive, slightly slanted style.

Maria Hooke  
Director, Exempt Organizations Examinations

**Enclosures:**  
Publication 892



Department of the Treasury  
Internal Revenue Service  
Tax Exempt and Government Entities Division  
Exempt Organizations Examination

Date:  
3/28/2018  
Taxpayer ID number:

Form:

Tax periods ended:

Person to contact:

Employee ID number:  
Telephone number:  
Fax:  
Address:  
Manager's contact information:

Employee ID number:  
Telephone number:  
Response due date.

### **CERTIFIED MAIL – Return Receipt Requested**

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

#### **Why you're receiving this letter**

We enclosed a copy of our audit report, Form 886-A, Explanation of Items, explaining that we propose to revoke your tax-exempt status as an organization described in Internal Revenue Code (IRC) Section 501(c)(3).

#### **If you agree**

If you haven't already, please sign the enclosed Form 6018, Consent to Proposed Action, and return it to the contact person shown at the top of this letter. We'll issue a final adverse letter determining that you aren't an organization described in IRC Section 501(c)(3) for the periods above.

After we issue the final adverse determination letter, we'll announce that your organization is no longer eligible to receive tax deductible contributions under IRC Section 170.

#### **If you disagree**

1. Request a meeting or telephone conference with the manager shown at the top of this letter
2. Send any information you want us to consider.
3. File a protest with the IRS Appeals Office. If you request a meeting with the manager or send additional information as stated in 1 and 2, above, you'll still be able to file a protest with IRS Appeals Office after the meeting or after we consider the information.

The IRS Appeals Office is independent of the Exempt Organizations division and resolves most disputes informally. If you file a protest, the auditing agent may ask you to sign a consent to extend the period of limitations for assessing tax. This is to allow the IRS Appeals Office enough time to consider your case. For your protest to be valid, it must contain certain specific information, including a statement of the facts, applicable law, and arguments in support of your position. For specific information needed for a valid protest, refer to Publication 892, How to Appeal an IRS Determination on Tax-Exempt Status.

Fast Track Mediation (FTM) referred to in Publication 3498, The Examination Process, generally doesn't apply now that we've issued this letter.

4. Request technical advice from the Office of Associate Chief Counsel (Tax Exempt Government Entities) if you feel the issue hasn't been addressed in published precedent or has been treated inconsistently by the IRS.

If you're considering requesting technical advice, contact the person shown at the top of this letter. If you disagree with the technical advice decision, you will be able to appeal to the IRS Appeals Office, as explained above. A decision made in a technical advice memorandum, however, generally is final and binding on Appeals.

**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 adverse determination letter.

**Contacting the Taxpayer Advocate Office is a taxpayer right**

The Taxpayer Advocate Service (TAS) is an independent organization within the IRS that can help protect your taxpayer rights. TAS can offer you help if your tax problem is causing a hardship, or you've tried but haven't been able to resolve your problem with the IRS. If you qualify for TAS assistance, which is always free, TAS will do everything possible to help you. Visit [www.taxpayeradvocate.irs.gov](http://www.taxpayeradvocate.irs.gov) or call 877-777-4778.

**Additional information**

You can get any of the forms and publications mentioned in this letter by visiting our website at [www.irs.gov/forms-pubs](http://www.irs.gov/forms-pubs) or by calling 800-TAX-FORM (800-829-3676).

If you have questions, you can contact the person shown at the top of this letter.

Sincerely,



Jerry Morrow for  
Maria Hooke  
Director, Exempt Organizations Examinations

**Enclosures:**

Examination Report - Forms 4621-A, Form 886-A  
Form 6018  
Publications 3498 & 892

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer		Year/Period Ended 12/31/20XX

**Issue:**

Whether \_\_\_\_\_ (“ \_\_\_\_\_”) continues to qualify for exemption under Section 501(c)(3) of the Internal Revenue Code.

**Facts:**

\_\_\_\_\_ (“ \_\_\_\_\_”) was granted tax-exempt status in December 20XX under Internal Revenue Code Section 501(c)(3) as an organization described in Sections 509(a)(1) and 170(b)(1)(A)(iii).

The organizations purpose as stated in the Articles of Incorporation is “to provide free medical services to the homeless and \_\_\_\_\_.” The Articles were later amended during the process of applying for tax exemption by adding the canned language for operating exclusively for 501(c)(3) purposes, not carrying on activities that are not permitted by 501(c)(3), and including the required dissolution clause. Further, the Bylaws stated the purpose was “to provide medical examination and treatment, without charge, to underprivileged individuals unable to afford such treatment.”

\_\_\_\_\_ founded \_\_\_\_\_ and is its President and Director. He is the main doctor at the organization and oversees the daily activities. \_\_\_\_\_ signs the checks and all documents on behalf of the organization.

\_\_\_\_\_ spouse, \_\_\_\_\_, is the Secretary of \_\_\_\_\_ as listed on the Form 990 and annual filings with the State of \_\_\_\_\_. The Form 990 also lists that the books and records are in the care of \_\_\_\_\_.

\_\_\_\_\_ provides medical care (similar to that of a primary care physician) to individuals without insurance charging fees based on various levels of income. Some of the services are performed free of charge, and the organization also accepts Medicare, Medicaid, and other forms of insurance. There is an approximate 0/0 split of gross receipts reported from Medicare/Medicaid versus what is reported from individuals and insurance. There is also no accounting for “no charge” services as there is not a general ledger account for donated services or any similar reporting of such services provided to those without insurance.

\_\_\_\_\_ has stated that they operate at multiple locations in \_\_\_\_\_, as well as a location in \_\_\_\_\_ and \_\_\_\_\_, and have provided a few utility bills for the various locations that are in the name of \_\_\_\_\_. It is unclear, however, as to the actual operations that occurred at each of the various locations. Research done by the Revenue Agent shows various related entities (owned, controlled, or influenced by \_\_\_\_\_) operated at many of the locations. Further, the financials of \_\_\_\_\_ only report income from two locations, \_\_\_\_\_ and \_\_\_\_\_ in \_\_\_\_\_.

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also states they conduct activities in \_\_\_\_\_, which are operated under the corporation \_\_\_\_\_ is an apparent "foreign subsidiary" of \_\_\_\_\_, established for \_\_\_\_\_ to conduct activities in \_\_\_\_\_. The foreign grants and assistance of \$0 reported on the form 990 represents the funds that \_\_\_\_\_ is reporting that have been disbursed to or for the benefit of the foreign organization. There were no checks written or wire transfers made from any of the organization's accounts that substantiate any of these grants or payments. A journal entry was made at the end of the year to report the total amount of grants reported. This entry was made directly against the officer's receivable account.

has 0 financial accounts across 0 different Banks/Credit Unions that were disclosed during the exam. It appears that Medicare receipts go into one account, Medicaid receipts into another account, and private insurance receipts into yet another account. Cash deposits are made into most accounts, usually in large round amounts ranging widely from \$0 up to \$0+. Additionally, multiple cash transfers between accounts are made with no apparent consistency for timing and/or amounts. Only one account has checks drawn against it, and most of the checks represent payroll or compensation to workers. One account has disbursements made via cashier's checks and money orders, zero accounts are almost exclusively used for debit card purchases, and all accounts have numerous transfers and cash withdrawals. Multiple cash withdrawals are made from many accounts and generally range from \$0 up to \$0 with a few larger withdrawals around \$0. On many occasions, there are two or more cash withdrawals in a single day. \_\_\_\_\_ has failed to provide substantiation for most of the transactions beyond providing copies of bank statements and the general ledger showing how the items were accounted for on the organizations books.

During the examination of \_\_\_\_\_, it was discovered that multiple checks, cashier's checks, and money orders were made payable to \_\_\_\_\_ and \_\_\_\_\_. There were also multiple cash withdraws made from \_\_\_\_\_ bank accounts that \_\_\_\_\_ had authority over as well as multiple transfers to personal accounts and payments made for personal expenses of the doctor and his spouse. The Revenue Agent requested documentation to substantiate the use of these funds, but \_\_\_\_\_ failed to provide the requested information. None of the expenditures in question were reported to \_\_\_\_\_ and \_\_\_\_\_ as compensation or fringe benefits, nor was there any evidence that the organization intended these funds to be compensation for services performed or that an accountable plan for reimbursements was established and maintained. A summary of these unsubstantiated transactions is as follows:

Checks/Certified Checks & Money Orders payable to _____	\$0.
Checks/Certified Checks payable to _____	\$0.
Miscellaneous Personal Expenses	0.
Non-Accountable Plan Expenditures	0.
Transfers to personal and unknown accounts	0.
Cash withdrawals & Cashed Checks/Money Orders	<u>0.</u>
Total unsubstantiated transactions	<u>\$0.</u>

In 20XX, as well as previous years, \_\_\_\_\_ & \_\_\_\_\_ received a salary from \_\_\_\_\_ which were reported on form W-2. However, in 20XX, \_\_\_\_\_ did not report any compensation paid to either \_\_\_\_\_ or \_\_\_\_\_ even though multiple payments were made payable directly to them as described above.

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Further, as indicated above, the Revenue Agent requested explanation and substantiation for the cash withdrawals and the checks written to & . The organization failed to provide any explanation or substantiation of the questionable transactions for 20XX. However, did provide very brief written explanations for similar questionable transactions which occurred in the previous tax period (20XX). Those reasons included:

- Vendor expenses
- for vendor payments & living expenses
- Vendors 401(k)
- Rent, utilities, and food for student
- Utilities and office supplies
- Transfers to other bank accounts to pay expenses
- Expenses for
- Attorney retainer and lawyer fees
- Living Allowances
- Doctor expenses
- Travel expenses
- Gas for home visits
- Expenses for X-mas
- IRS tax payments
- Scholarships (covering assistance w/ housing, utilities, vehicles, schooling, & spending money)
- Office vehicle expenses
- Schooling
- Vehicle purchases
- Housing costs
- Repairs
- Payroll
- Patient help
- Bail Bonds
- School fees and expenses for students
- Buying used cars and shipping to
- Advertising
- Book Publishing

No substantiation was provided to accompany these general explanations.

In a written response to IRS requests for substantiation of questionable expenditures, stated "the board of directors for , in 20XX-20XX, agreed to pay my living expenses due to a low salary and working 16 hours/day 6 days/week." The organization did not report any of the living expenses paid for the benefit of and his family as compensation to either or . They also did not provide a copy of the meeting minutes to demonstrate that Board agreed to pay these living expenses.

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Form 990, *Return of Organization Exempt from Income Tax*, for year ended 12/31/20XX reported a loan receivable from officers/directors of \$0. This was an increase of \$0 over the previous years reported balance. Schedule L of the Form 990 stated that the loans were made to as a "temporarily loan used to make out of pocket purchases for the clinic, which will be recorded in periods after 20XX" and that there was no written loan agreement. There was also no indication that the loans were approved by the Board. A review of the related "officer's receivable" general ledger account, which was provided during the exam, showed the checks, certified checks, money orders, transfers, and cash withdrawals listed above were booked to the "officer's receivable" general ledger account. Additionally, many of the items listed above which have been determined to be personal expenses are also recorded in the "officer's receivable" account. The organization failed to provide documentation to substantiate that there was a true loan agreement between and . Specifically, was unable to produce a written loan agreement or any other document to demonstrate the existence of a loan. Further, there was no evidence of a repayment schedule or indication that interest was being charged.

The prior tax period, ending 12/31/20XX was the initial period opened for examination based on possible inurement and excess benefit transactions. The examination scope was expanded into the subsequent period (20XX) to further address issues identified during the examination of the 20XX tax period. Due to an imminent statute on the prior tax period for which the organization refused to extend, the exam on the 12/31/20XX tax period had to be closed separately from the 12/31/20XX tax period. The fact pattern presented above for the 20XX tax period was similar in the 20XX tax period.

According to news articles from various sources, including a press release from the State of

During a discussion with the organization's designated power of attorney in December 20XX, it was stated that he believed the organization had ceased operations, but had received no official notification or documentation from . The Revenue Agent conducted a physical visit on 12/20/20XX to of the locations stated they operate and verified that there was no presence of being operational. The locations on and In had notices posted that they were closed and the last day for patient records to be picked up was 12/7/20XX. There was no one present at any of the locations, and the and locations had no signage suggesting that had operated there.

A letter from was received on 2/8/20XX stating that he moved to , . He stated that he lost everything in in his effort to help the poor and cannot afford to live in anymore. He requested that the case be transferred to his new accountants in . There was no form 2848 included with the letter authorizing contact with the new accountants. Further, there was no phone number listed on the letter to contact or and the address was a PO Box.



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As of the date of this report, \_\_\_\_\_ has still not filed a 20XX form 990. They have not filed anything with the State of \_\_\_\_\_ to terminate their operations, such as dissolution paperwork, and still show "active" on the State's website. Although \_\_\_\_\_ recently filed a 20XX form 990, it was not marked as a final return, and compared to the returns filed for 20XX & 20XX, had multiple inconsistencies, listed no info for the prior year (20XX), and had no beginning balances listed on the balance sheet.

**Law:**

IRC Section 501(c)(3) provides tax exemption for corporations and foundations that are operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, 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(a)(1) states that in order to be exempt as an organization described in IRC Section 501(c)(3), an organization must be both organized and operated exclusively for one or more 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 Section 1.501(c)(3)-1(c)(1) states that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in Section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Treasury Regulation Section 1.501(c)(3)-1(c)(2) states 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. The words "private shareholder or individual" refer to persons having a personal and private interest in the activities of the organization. Treas. Reg. § 1.501(a)-1(c). Such private shareholders or individuals are commonly referred to for convenience as "insiders."

Treasury Regulation Section 1.501(c)(3)-1(d)(1)(ii) states that an organization is not organized or operated exclusively for one or more of the purposes specified in IRC Section 501(c)(3) 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.

In Better Business Bureau v. United States, 326 U.S. 279, 66 S. Ct. 112, 90 L. Ed. 67, 1945 C.B. 375 (1945), the United States Supreme Court held that regardless of the number of truly exempt purposes, the presence of a single substantial non-exempt purpose will preclude exemption under Section 501(c)(3).

In People of God Community v. Commissioner, 75 T.C. 127, 133 (1980), the Tax Court held that, even though the statutory prohibition on inurement is stated in terms of net earnings, the inurement doctrine applies to unjust enrichment from an organization's gross earnings as well. See also Harding Hospital, Inc. v. United States, 505 F.2d 1068, 1072 (6th Cir. 1974).

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In Founding Church of Scientology v. U.S., 412 F. 2d 1197, 188 Ct. Cl. 490 (Ct. Cl. 1969), the court stated that loans to an organization's founder or substantial contributor can constitute inurement that is prohibited under Section 501(c)(3). In that case, the church made loans to its founder and his family and failed to produce documentation that demonstrated that the loans were advantageous to the church. The church also failed to produce documentation to show that the loans were repaid. Significantly, the court stated that "the very existence of a private source of loan credit from an organization's earnings may itself amount to inurement of benefit." Id. at 1202; see also John Marshall Law School & John Marshall University v. United States, 228 Ct. Cl. 902, 81-2 USTC 9514 (Ct. Cl. 1981) (noting that "the very existence of a private source of loan credit from an organization's earnings may itself amount to inurement of benefit"); Unitary Mission Church of Long Island v. Comm'r, 74 T.C. 507, 515 (1977) (same); Lowry Hosp. Ass'n v. Comm'r, 66 T.C. 850 (1976) (concluding that a hospital did not qualify for exemption under § 501(c)(3) because some of its net earnings inured to the benefit of the physician who was the organization's founder when most of the hospital's assets were loaned to a nursing home owned by the founder at interest rates that were below-market (given the level of risk involved) and not repaid until nearly 6 to 8 years later).

In Western Catholic Church v. Commissioner, 73 T.C. 196 (1979), aff'd 631 F.2d 736 (7th Cir. 1980), the Tax Court considered a church that invested in an office building that met the needs for office space of one of church founder's wholly-owned businesses. Even though the office building may have been a good investment for the church and even though the business paid a reasonable rent, the court concluded that when the church's "investments are dictated in part by the needs of private interests, it cannot be said that [the church] was operated exclusively for the public benefit." Id. at 214. The court also considered a variety of loan transactions between the church and the founder's businesses. Although inadequate records made it impossible to trace completely the financial transactions, the court determined that "it is clear that money passed back and forth between [the church] and [the founder] and his businesses whenever one or the other needed the cash." Id. The church was thereby utilized by the founder "as an 'incorporated pocketbook' into which he could transfer excess personal funds, claiming tax deductions, while he still retained complete control of the funds and used them for purposes unrelated to religious activities." Id. Based on these and other facts, the court found that the church had failed to establish that no part of its net earnings inured to the benefit of a private shareholder or individual.

In Revenue Ruling 67-5, 1967-1 C.B. 123, it was held that a foundation controlled by the creator's family was operated to enable the creator and his family to engage in financial activities which were beneficial to them, but detrimental to the foundation. It was further held that the foundation was operated for a substantial non-exempt purpose and served the private interests of the creator and his family. Therefore, the foundation was not entitled to exemption from Federal income tax under Section 501(c)(3).

Since inurement and private benefit issues are highly fact dependent, the courts do not look with favor on an organization's failure to provide relevant facts and they are not hesitant to find that an organization has failed to carry its burden. See Gondia Corporation v. Commissioner, TC Memo. 1982-422; Schoger Foundation v. Commissioner, 76 T.C. 380 (1981); The Basic United Ministry of Alma Karl

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Schurig v. Commissioner, 216 U.S. App. D.C. 391, 670 F.2d 1210 (1982); First Libertarian Church v. Commissioner, 74 T.C. 396 (1980); Church of Gospel Ministry, Inc. v. United States, 640 F. Supp. 96, 58 AFTR 2d 5232 (D.C. 1986); Universal Bible Church, Inc. v. Commissioner, T.C. Memo. 1986-170.

IRC Section 4958(c)(1)(A) defines an excess benefit transaction in general as any transaction in which an economic benefit is provided by an applicable tax exempt organization directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit. An economic benefit shall not be treated as consideration for the performance of services unless such organization clearly indicated its intent to so treat such benefit

IRC Section 4958(f)(1) defines "disqualified person" with respect to any transaction as -- (i) any person who was at any time during the 5 year period ending on the date of such transaction, in a position to exercise substantial influence over the affairs of the organization, (ii) a member of the family of an individual described in subparagraph (A), or (iii) a 35-percent controlled entity

Treasury Regulation Section 53.4958-4(a)(4) provides that certain economic benefits are disregarded for purposes of Section 4958, including benefits excluded from income under Section 132 of the Code and expense reimbursement payments pursuant to an accountable plan that meets the requirements of Section 1.62-2(c) and Sections 53.4958-4(a)(4)(i) and (ii) of the Regulations.

Treasury Regulation Section 53.4958-4(c)(1) provides that an economic benefit is not treated as consideration for the performance of services (i.e., compensation) unless the organization providing the benefit clearly indicates its intent to treat the benefit as compensation when the benefit is paid. If an organization fails to provide contemporaneous substantiation of such intent, any services provided by the disqualified person will not be treated as provided in consideration for the economic benefit for purposes of determining the reasonableness of the transaction. If the substantiation requirement is not satisfied, then the value of the benefit will be treated as an automatic excess benefit taxable under Code section 4958(a).

Treasury Regulation Section 53.4958-4(c)(3)(A) provides that a benefit may be contemporaneously substantiated as compensation (i) if the organization reports the benefit as compensation on a federal tax information return; or (ii) if the disqualified person timely reports the value of the benefit as income on the person's federal income tax return; or (iii) if the benefit is described as compensation to the disqualified person in a contemporaneous employment contract, board of directors minutes, or other documents indicating that an authorized body of the organization approved the benefit as compensation.

IRC Section 62(a)(2)(A) and Treasury Regulation Section 1.62-2(b) provide that, for purposes of determining adjusted gross income, an employee may deduct certain business expenses paid by the employee in connection with the performance of services as an employee under a reimbursement or other expense allowance arrangement with his employer.

IRC Section 62(c) provides that, for purposes of Section 62(a)(2)(A), an arrangement will be treated as a reimbursement or other expense allowance arrangement if (1) the arrangement requires the employee

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to substantiate the expenses to the payor, and (2) the arrangement requires the employee to return to the payor any amount in excess of the substantiated expenses.

Thus, a reimbursement or other expense allowance arrangement satisfies the requirements of Section 62(c) only if it meets the requirements of business connection, substantiation, and returning amounts in excess of substantiated expenses. If an arrangement meets these requirements, all amounts paid under the arrangement are treated as paid under an accountable plan. Treas. Reg. § 1.62-2(c)(2)(i). Amounts treated as paid under an accountable plan are excluded from the employee's gross income, are not required to be reported on the employee's Form W-2, and are exempt from the withholding and payment of income and employment taxes. Treas. Reg. § 1.62-2(c)(4).

If an arrangement does not satisfy these requirements, all amounts paid under the arrangement are treated as paid under a "nonaccountable plan." Treas. Reg. § 1.62-2(c)(3). Amounts treated as paid under a nonaccountable plan are included in the employee's gross income, must be reported as wages or other compensation of the employees on Form W-2, and are subject to withholding and payment of income and employment taxes. Treas. Reg. § 1.62-2(c)(5).

Treasury Regulation Section 1.274-5 addresses the substantiation requirements with respect to the business purpose of an expense. If the substantiation requirements are not met no deduction is allowed with respect to that expense.

IRC Section 274(d) provides that no deduction or credit shall be allowed (1) under Sections 162 or 212 for any traveling expense, (2) for any item with respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, or with respect to a facility used in connection with such an activity, (3) for any expense for gifts, or (4) with respect to any listed property (as defined in Section 280F(d)(4)) unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating the taxpayer's own statement regarding amount, time and place, business purpose and business relationship.

Treasury Regulation Section 1.274-5T(b) requires each employee to provide substantiation of the business purpose of each expense, generally in writing.

Treasury Regulation Section 1.274-5T(b)(2) provides that no deduction or credit shall be allowed for travel unless the taxpayer substantiates the following elements: (1) Amount -- amount of each separate expenditure for traveling away from home; (2) Time -- dates of departure and return for each trip away from home and number of days away from home spent on business; (3) Places -- destinations or locality of travel and (4) Business purpose -- business reason for travel or nature of the business benefit derived as a result of the travel.

Treasury Regulation Section 1.274-5T(b)(6) provides the elements that must be proved with respect to an expenditure for listed property to include the amount of each separate expenditure, the amount of business/investment use, the date of the expenditure or use, and the business or investment purpose.

Treasury Regulation Section 1.274-5T(c)(2)(i) states that a taxpayer, to meet the "adequate records" requirements of Section 274(d), shall maintain an account book, diary, statement of expense or similar

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record and documentary evidence which, in combination, are sufficient to establish each element of an expenditure.

Treasury Regulation Section 1.274-5T(c)(2)(ii) states that the account book, diary, statement of expense or similar record must be prepared or maintained in such manner that each recording of an element of an expenditure is made at or near the time of the expenditure

Treasury Regulation Section 1.274-5T(c)(2)(iii), and for periods after January 20, 2000, Treasury Regulation Section 1.274-5(c)(2)(ii), requires the employee to maintain documentary evidence, such as receipts, paid bills, or similar evidence.

Treasury Regulation Section 1.274-5T(c)(3) provides that if an employee fails to establish to the satisfaction of the Service that the employee has substantially complied with the adequate records requirements of the regulations, the employee may satisfy such requirement by providing (i) the employee's own statement, whether written or oral, containing specific information in detail as to each element, plus (ii) other corroborative evidence sufficient to establish each element.

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

IRC Section 6033(a)(1) provides, except as provided in Section 6033(a)(2), every organization exempt from tax under Section 501(a) shall file an annual return, stating specifically the items of gross income, receipts and disbursements, and such other information for the 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.

Treasury Regulation Section 1.6001-1(a) in conjunction with Section 1.6001-1(c) 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, 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 Section 6033.

Treasury 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.

Treasury 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

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enabling him to inquire further into its exempt status and to administer the provisions of subchapter F (Section 501 and the following), chapter 1 of the Code and Section 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 Section 6033 of the Code and the regulations which implement it, may result in the termination of the exempt status of an organization previously held exempt, on the grounds that the organization has not established that it is observing the conditions required for the continuation of exempt status.

In accordance with the above cited provisions of the Code and regulations under Sections 6001 and 6033, organizations recognized as exempt from federal income tax must meet certain reporting requirements. These requirements relate to the filing of a complete and accurate annual information (and other required federal tax forms) and the retention of records sufficient to determine whether such entity is operated for the purposes for which it was granted tax exempt status and to determine its liability for any unrelated business income tax.

**Government's Position:**

Based on the examination conducted, it has been concluded that [redacted] does not continue to qualify for tax-exempt status as an organization described in Section 501(c)(3) of the Code. Although [redacted] has engaged in regular and ongoing activities that further exempt purposes, it has engaged in multiple excess benefit transactions therefore jeopardizing its exemption. Additionally, [redacted] has failed to provide and maintain adequate records to substantiate the activities and expenditures of the organization.

[redacted] controls [redacted] operation and financial affairs. He founded the organization, is the President, and he makes decisions for [redacted]. His spouse, [redacted], is the Secretary of [redacted]. They exert substantial influence over the organization for purposes of the excess benefits under Section 4958 of the Code.

[redacted] holds several bank accounts across various banks and credit unions. Only one account has checks drawn against it, and most of the checks represent payroll or compensation to workers. One account has disbursements made via cashier's checks and money orders, two accounts are almost exclusively used for debit card purchases, and all accounts have numerous transfers and cash withdrawals. [redacted] has failed to maintain adequate records to substantiate the majority of the disbursements and cash transactions. Further, in reviewing the General Ledger that was provided during the examination, many of these transactions were recorded in the officer's receivable ledger account. In fact, all checks, cashier's checks, and money orders payable to [redacted] and/or [redacted], along with all cash withdraws, and many transfers to accounts not held by [redacted] were all recorded in the Officer's Receivable general ledger account.

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Since these transactions are recorded as a "Loan" to \_\_\_\_\_, consideration must be given as to whether a bon-a-fide loan exists and if so, whether the loan creates inurement to \_\_\_\_\_.

There are several factors that are considered in determining if an actual loan existed. The key factors generally taken into consideration are evidence of a loan agreement (usually written), interest charged on the loan, and some sort of repayment schedule. In this particular case, \_\_\_\_\_ was not able to provide a loan agreement or other acceptable evidence, such as board minutes showing terms and board approval of the loans. Further, there was no evidence of any sort of repayment schedule, and there was no indication that any repayments were, or had been made. Additionally, there was no indication or evidence that interest was being charged on the amounts reported as loans. Based on the lack of evidence to substantiate these reported loans, it has been determined that an actual loan does not exist and the funds recorded to the officer's receivable account are simply the officer's use of the organizations assets and most likely excess benefit transactions.

After the reaching the conclusion that a bon-a-fide loan did not exist between \_\_\_\_\_ and \_\_\_\_\_, the next issue considered regarding the checks payable to \_\_\_\_\_ & \_\_\_\_\_, the cash withdrawals and transfers reported in the officer's receivable account is whether there was an accountable plan in place to account for some of these transactions. The filed Form 990 for 20XX provided an explanation of the amounts reported as officer's receivable as advances to \_\_\_\_\_ for future out of pocket business expenses to be incurred and reported in future periods. If this is the explanation for the checks, cash, and transfers in question, then an accountable plan must have been in place and adequately maintained or these transactions would be considered occurring under a non-accountable plan, and as such would be reportable income to the doctor and his wife. During our consideration of the existence of an accountable plan, three main factors must all occur. There must be a business connection, appropriate substantiation, and return of excess funds for each transaction to meet the requirements of an accountable plan. In this case, \_\_\_\_\_ was unable to provide evidence of a business connection and failed to provide the required level of substantiation. Further, there was no evidence that any excess funds that were advanced were returned within a reasonable period of time. It has been determined that there was not an accountable plan in place relating to the questionable transactions since there was insufficient evidence that the required elements were met.

It was also determined during the examination that travel, automobile, meetings, and meals & entertainment expenses were paid using a debit card from two of \_\_\_\_\_ accounts. \_\_\_\_\_ did not maintain any receipts, or correspondence confirming the business purpose of these expenditures. Without evidence that these expenses serve any kind of a charitable purpose, or that it was ordinary and necessary to carry out a charitable program, we can only conclude that any expense \_\_\_\_\_ incurs for these items is inurement since they were not substantiated, nor were they reported as compensation.

The unsubstantiated transactions described above have been determined to be automatic excess benefit transactions resulting in inurement to \_\_\_\_\_ and his spouse. The Service has sufficient information to establish a pattern of control on the part of \_\_\_\_\_ and his spouse has resulted in continuing inurement to them as insiders. Further, \_\_\_\_\_ abused his position within \_\_\_\_\_ to commit \_\_\_\_\_ thru \_\_\_\_\_ which allowed him to further his economic benefit received from the organization. We believe that a correction under IRC Section 4958 would not be sufficient to allow \_\_\_\_\_ to retain its exempt status. It is expected that

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will continue to be controlled by . Further, although has indicated that is no longer in operation, he has failed to take the appropriate steps to formally terminate the organization. Revoking the tax exemption of will prevent the potential for the organization to sit dormant for a few years and then re-establish activities that continue to be used for a private, rather than public benefit.

has engaged in regular and ongoing activities that further exempt purposes both before and after the excess benefit transactions occurred. However, the size and scope of the excess benefit transactions engaged in by collectively, are significant in relation to the size and scope of activities that further exempt purposes. Moreover, has been involved in repeated excess benefit transactions, all of which have created inurement to insiders. has not implemented any safeguards that are reasonably calculated to prevent future diversions. Additionally, the excess benefit transactions have not been corrected. Further, has failed to maintain the required records to substantiate the activities and expenditures for exempt purposes. Based on the application of the factors to these facts, is no longer described in Section 501(c)(3) effective January 1, 20XX.

**Conclusion:**

Based on the above, we propose to revoke tax-exempt status. This proposed revocation would become effective January 1, 20XX. Any contributions to are no longer deductible as charitable contributions. Any contributions to this organization by those who were in part responsible for, or were aware of, the activities or deficiencies on the part of the organization that gave rise to loss of exempt status will not be allowed as a deduction effective the date of revocation.

will be required to file Form 1120 for the tax period ending December 31, 20XX, as well as all subsequent tax periods.