

# Preventing and Surviving an Audit



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# Charity Regulation

Now that the charitable organization has been formed, who will regulate it?



# Charity Regulation

## Charity Regulators:

- IRS:
  - The federal regulatory body that grants/revokes your organization's 501(c)(3) tax exempt status.
  - The federal regulatory body that assures the organization: 1.) benefits the public at large (not a narrow class of private folks); 2.) is not improperly benefitting insiders (directors, officers, family members of officers/directors, etc.); 3.) is accomplishing its charitable purpose; and 4.) is receiving support from a wide enough base of donors (not 1 or 2 families).
- State Incorporation Office
  - The state regulatory body that incorporates/merges/dissolves corporations, and requires annual registrations and/or annual reports.
  - <http://www.coordinatedlegal.com/SecretaryOfState.html>
- State Charity Registrar:
  - The state regulatory body that governs charitable solicitations (i.e., whether the solicitations are deceptive/misleading; whether the money raised is being used for a charitable purpose; and whether professional fundraisers are registered, bonded, and honoring their obligations).
  - The state regulatory body that assures the charity honors its donors' intent.
  - The state regulatory body that assures the Board is abiding by their fiduciary duties.
  - <http://www.nasconet.org/documents/u-s-charity-offices/>
- State Department/Bureau of Taxation
  - The state regulatory body that collects state employer withholdings tax, state sales/use tax, unrelated business income (usually this includes gambling revenues), and state income tax (unless exempt).
  - <https://www.harborcompliance.com/information/authority/departement-of-revenue>
- County/State Property Tax Regulator – the county or state regulatory body that assesses, collects, and exempts tax on parcels of property.
- State Charity Gambling Regulator – the state regulatory body that issues permits/licenses to qualifying nonprofit corporations so they can utilize various types of gambling as fundraisers.



# Charity Regulation

What do these charity regulators look for?

What are their red flags?



# IRS – Red Flags

- Inadvertent disclosures on Form 990 or Form 1023/1023EZ (client checks something on the form and has no clue the consequence – i.e., they answer “no” and should have answered “yes.”)
- Indications that the nonprofit is truly operated for private (not public) interests – i.e., church has an airplane that is being misused by the pastor, or a major theft/embezzlement was reported
- Money is consistently paid to non-charitable interests:
  - Loans to for-profits
  - Excessive payments to for-profits
  - Excessive compensation
  - Non-fixed compensation (bonuses, severance packages, deferred compensation, fringe benefits, and/or retirement)
- Too much UBIT – i.e., substantial nonexempt (taxable) activity
- Political activity – either “too much” or the “wrong kind”
- Lack of revenue diversity – i.e., public charity has only 1-2 donors and a determination needs to be made regarding whether it should be classified as public charity or a foundation.
- Complaint(s) filed against organization.



## State Incorporation Office – Red Flags

- There is no audit or review – just good or bad standing – so there are no “red flags.”
- Generally, nonprofits need to need to renew their registrations and/or file an annual report.
- If there is a failure to register/file, the nonprofit will be “involuntarily dissolved.”



## Attorney General – Red Flags

- Organizations/Boards/Directors/Officers or individuals intentionally permitting the nonprofit's charitable assets to be misused by private persons.
- Intentional deceptive/misleading solicitations by either the charity or professional fundraiser.
- Complaint(s) filed against organization.
- Refusal to register/comply with registration requirements.



## State Dept. of Revenue – Red Flags

- Failure to file/comply with all filing requirements.
- Collecting tax but failing to remit it (this is tax evasion, folks).
- Remitting an incorrect amount of tax (either intentionally or unintentionally).
- Engaging in charitable gambling or other UBIT.





## State/County Property Tax – Red Flags

- Substantial change in use that is not in line with the organization’s purpose/mission.
- Change in ownership (title holder changes).
- Most property tax regulators reassess property tax exemption every few years to confirm facts and circumstances have not changed. This is not necessarily an “audit,” but a review.



## State Charity Gambling – Red Flags

- Generally, nonprofits need to renew their permit/license yearly with fee.
- There is no audit, just a review so state charity gambling regulators can confirm facts and circumstances have not changed and that all necessary paperwork/taxes have been remitted.
- Items that would hold up the process or trigger a revocation would be: permit/license violations, failure to file/comply with all filing requirements, and failure to remit taxes.



# Charity Regulation

Sometimes, when there are red flags, the result is a review (investigation, compliance check, audit). What does that look like?



# What a Review Looks Like

## **IRS**: Initial Contact and Letter

- Depending on the type of review, you will initially be contacted either by letter or phone call, which will include the name of the IRS personnel as well as the employee's badge number. The IRS does not use e-mail to initiate contact with an organization.
- In all reviews, IRS personnel will mail a letter along with a list of documents and records needed to conduct an audit or compliance check. The letter will contain contact information for both the individual conducting the review as well as the individual's manager.



**Internal Revenue Service**  
**Tax Exempt and Government Entities Division**  
Exempt Organizations: Examinations  
30 East 7th Street, Suite 1130B  
Mail Stop 4925  
St Paul, MN 55101

**Department of the Treasury**

**Date:**  
September 9, 2015  
**Taxpayer Identification Number:**  
  
**Form:**  
990 Return  
**Filing Period Ended:**  
December 31, 2013  
**Person to Contact/ID Number:**  
Mona Shipman  
0207961  
**Contact Numbers:**  
Phone: 651-312-7679  
Fax: 855-209-7539  
**Manager's Name/ID Number:**  
Robert Owens/1000876021  
**Manager's Contact Number:**  
(502) 318-0386

**Example of  
IRS Initial  
Audit Contact  
Letter**

Dear

Your organization has been selected for an audit for the year indicated above. The Internal Revenue Service (IRS) routinely audits exempt organizations to ensure compliance with federal tax requirements. **Because I was unable to contact you by phone, I've scheduled an audit for October 5-8, and October 13, 2015. The initial appointment date and time is scheduled for October 05, 2015 at 9:00 am at the location listed above. Please call me as soon as possible to confirm this appointment. My phone number is listed above.**



# What a Review Looks Like

**IRS:** <https://www.irs.gov/Charities-&-Non-Profits/Exempt-Organizations-Audit-Process>

- The IRS conducts several types of compliance checks based on its statutory federal authority:
  - Audits: There are two types of audits
    - **Field audit (or examination)**: If the initial contact letter sets up an appointment for an IRS agent to visit the organization's premises, the IRS is conducting a field audit.
    - **Office/correspondence audit (or examination)**: If the letter asks you to deliver documents to an IRS office by mail, the IRS is conducting a correspondence audit.
  - Non-audits: If the letter indicates the IRS is conducting a compliance check, then you're not being audited.
  - Note: The IRS also sometimes asks organizations to complete questionnaires to help them better understand how organizations satisfy federal tax law requirements. Neither compliance checks nor compliance check questionnaires are audits.
- Organizations are selected for reviews for a variety of reasons, and the scope of the audit or compliance check will vary based on the type of review.
- An audit starts with the initial contact and continues until a closing letter is issued. A compliance check or compliance check questionnaire starts with the initial contact. The IRS may contact the organization again if the IRS needs further information, or if the organization does not respond to the compliance check or questionnaire. The IRS typically issues a closing letter at the end of a compliance check, but not at the end of a compliance check questionnaire.



# What a Review Looks Like

## **Attorney General's Office: Initial Contact and Letter**

- Generally, initial contact will be made by letter, which will be sent to the organization's registered address as well as personally to each Director the office has on file.
- The letter will include a list of documents and records needed. The letter will contain contact information for the individual conducting the review.
- The AGO conducts investigations and compliance checks based on its civil statutory authority.
- In most states, the AGO has certain civil statutory authority that private citizens do not have:
  - Request the court award civil fines/penalties for solicitation violations (up to \$25,000 per violation);
  - Petition the court for removal of Officers/Directors for breach of fiduciary duty/breach of trust;
  - With respect to charitable trusts and charitable assets (in mergers, dissolutions, consolidations, or transfers of all (or substantially all) of their assets: If proceedings are commenced without proper notice upon the attorney general, a judgment or order rendered in the proceedings is voidable, unenforceable, and, upon the attorney general's motion seeking relief, may be set aside.



LORI SWANSON  
ATTORNEY GENERAL

STATE OF MINNESOTA  
OFFICE OF THE ATTORNEY GENERAL

December 9, 2014

SUITE 1200  
445 MINNESOTA STREET  
ST. PAUL, MN 55101-2130  
TELEPHONE: (651) 296-9412

Example of  
AGO  
Request for  
Information

Dear Ladies and Gentlemen:

This Office has reviewed \_\_\_\_\_ Fund's Annual Report filings for the year ending December 31, 2013, including IRS Forms 990 and audited financial statements.

As you may be aware, under Minnesota law, this Office has authority to conduct investigations and initiate proceedings to ensure compliance with the Minnesota Charitable Solicitation Act, Minn. Stat. ch. 309 (2012). Specifically, under Minn. Stat. § 309.533, subd. 1(a), the Attorney General "may make public or private investigations within or outside the state as deemed necessary by the attorney general to determine whether any person has violated or is about to violate any provision of sections 309.50 to 309.61 or any rule or order thereunder." A review of \_\_\_\_\_'s filing has raised questions regarding its charitable solicitation activities in Minnesota. At this time, I ask for \_\_\_\_\_'s voluntary cooperation with this informal request to allow this Office to evaluate this matter further. Accordingly, please provide the following documents and information to this Office by the close of business on **December 30, 2014**:





# What a Review Looks Like

## Attorney General's Office:

- The AGO generally provides a period of time for the organization to collect all requested information and provide it to the AG's Office by mail or hand delivery.
- Tip: Be VERY organized and complete with your response. Label the answers with tabs, sub tabs, and a cover letter. Provide logical explanations and be forthcoming.
  - Remember that the AGO is asking for documents and information at a disadvantage – it doesn't know what actually exists and what doesn't. If the AGO asks for a document that doesn't exist, SAY SO (don't just fail to produce it)! If the AGO fails to ask for a document that exists and would help clear things up, PRODUCE IT!
  - Do not play cat and mouse or “hide the ball” – when the investigation ends and the harmful information surfaces, if you don't disclose it (and the AGO “finds” it), that will be worse than if you bring it to the AGO's attention, steal its thunder, and explain why it's not as bad as it may seem.
- The AGO may contact the organization again if it needs further information, or if the organization does not respond to the request for information. Sometimes there are significant lapses in requests.
- The AGO will usually not send a closing letter, even once the AGO has all the information it needs to complete its investigation. That's just how most AG's Offices work. It's incredibly frustrating and nerve-wracking for practitioners and clients. No news is usually good news.
- If there is complete failure to comply, the organization may be sued.



# Charity Regulation

Sometimes we can prevent a review by requesting official guidance from the charity regulator. What's that about?



# Ask for Official Guidance

When in doubt, ask the IRS for guidance!: <https://www.irs.gov/pub/irs-irbs/irb15-01.pdf>

1. **Request a Determination Letter** – A “determination letter” is a written determination issued by a Director that applies the principles and precedents previously announced by the Service to a specific set of facts. It is issued only when a determination can be made based on clearly established rules in a statute, a tax treaty, the regulations, a conclusion in a revenue ruling, or an opinion or court decision that represents the position of the Service. Common. For example, submit a Form 1023EZ, Form 1023, Form 1024 and receive a determination letter.
2. **Request a Private Letter Ruling** (addressed in detail in coming slides)
3. **Request a Closing Agreement:**
  - A “closing agreement” is a final agreement between the Service and a taxpayer on a specific issue or liability. It is entered into under the authority in § 7121, and it is final unless fraud, malfeasance, or misrepresentation of a material fact can be shown.
  - A taxpayer may request a closing agreement with a letter ruling or in lieu of a letter ruling, with respect to a transaction that would be eligible for a letter ruling. In such situations, the Associate Chief Counsel with subject matter jurisdiction signs the closing agreement on behalf of the Service.
  - A closing agreement may be entered into when it is advantageous to have a matter permanently and conclusively closed or when a taxpayer can show that there are good reasons for an agreement and that making the agreement will not prejudice the interests of the Government. In appropriate cases, a taxpayer may be asked to enter into a closing agreement as a condition for the issuance of a letter ruling.



# Ask for Official Guidance

When in doubt, ask the IRS for guidance!: <https://www.irs.gov/pub/irs-irbs/irb15-01.pdf>

4. **Request an Information Letter** – An “information letter” is a statement issued by an Associate office or Director that calls attention to a well-established interpretation or principle of tax law (including a tax treaty) without applying it to a specific set of facts. An information letter may be issued if the taxpayer’s inquiry indicates a need for general information or if the taxpayer’s request does not meet the requirements of a private letter ruling and the Service concludes that general information will help the taxpayer. An information letter is advisory only and has no binding effect on the Service.
5. **Request oral advice:**
  - Call TE/GE at (877) 829-5500
  - All oral guidance is advisory only, and the Service is not bound by it.
  - The Service does not orally issue letter rulings or determination letters, nor does it issue letter rulings or determination letters in response to oral requests from taxpayers. Service employees ordinarily will discuss with taxpayers or their representatives inquiries about whether the Service will rule on particular issues and about procedural matters regarding the submission of requests.
  - At the discretion of the Service and as time permits, Service employees may also discuss substantive issues with taxpayers or their representatives. Such a discussion does not bind the Service.



## 2. Private Letter Rulings

What are they?:

- **Private letter rulings** (PLRs), in the United States, are written decisions by the IRS in response to taxpayer requests for guidance. A private letter ruling is “a written statement issued to a taxpayer by an Associate Chief Counsel Office of the Office of Chief Counsel or by the Tax Exempt and Government Entities Division that interprets and applies the tax laws to a specific set of facts.” <https://www.irs.gov/Tax-Exempt-Bonds/TEB-Private-Letter-Ruling:-Some-Basic-Concepts>
- A PLR is appropriate when the issuer/taxpayer wishes to confirm with the IRS that a prospective transaction will not likely result in a tax violation.
- A private letter ruling binds only the IRS and the requesting taxpayer. Thus, a private ruling may not be cited or relied upon as precedent by other taxpayers.
- The IRS does have the option of redacting the personal content of a private ruling and issuing it as a revenue ruling, which becomes binding on all taxpayers and the IRS.



## 2. Private Letter Rulings

### Revenue Procedure 2015-1:

- Revenue Procedure 2015-1 sets forth the issues on which taxpayers may request PLRs and the circumstances under which the IRS does not issue PLRs. It also provides instructions on what documents and information are to be provided as well as on procedural requirements. Appendix A provides a schedule of user fees. Appendix B provides a sample format for a PLR request. Appendix C provides a checklist to ensure that the PLR request is complete. This revenue procedure is updated annually.
- <https://www.irs.gov/pub/irs-irbs/irb15-01.pdf>



## 2. Private Letter Rulings

### When can you NOT get a Private Letter Ruling (PLR)?:

- No “in the alternatives”: The Service will not issue a letter ruling or a determination letter on alternative plans of proposed transactions or on hypothetical situations.
- No “comfort” letter rulings: A letter ruling will not be issued with respect to an issue that is clearly and adequately addressed by statute, regulations, decision of a court, revenue rulings, revenue procedures, notices, or other authority published in the Internal Revenue Bulletin (Comfort Ruling). However, except with respect to issues under § 332, 351, 355, 368, or 1036 and the tax consequences resulting from the application of such Code sections (see generally section 6.03), the Associate office may, in its discretion, decide to issue a Comfort Ruling if the Associate office is otherwise issuing a letter ruling to the taxpayer on another issue arising in the same transaction.
- No letter if the same issue, involving the same taxpayer or a related taxpayer, is pending in a case in litigation or before Appeals
- No letter if the request involves an industry-wide problem.
- No letter if the IRS doesn’t have jurisdiction
- Subject specific: See, specifically, Revenue Procedure 2015-1, pp.9-21.  
<https://www.irs.gov/pub/irs-irbs/irb15-01.pdf>



## 2. Private Letter Rulings

### How do you get a Private Letter Ruling (PLR)?: Part 1

- Follow the rules! <https://www.irs.gov/pub/irs-irbs/irb15-01.pdf>
- Submit the correct documents/info:
  - Complete statement of facts and other information relating to the transaction:
    - Names addresses, telephone numbers and SSNs/EINs of all interested parties;
    - The annual accounting period, and the overall method of accounting (cash or accrual) for maintaining the accounting books and filing the Federal income tax return, of all interested parties;
    - A description of the taxpayer's business operations;
    - A complete statement of the business reasons for the transaction;
    - A detailed description of the transaction; and
    - All other facts relating to the transaction or to the taxpayer's requested tax treatment
  - Copies of all contracts, wills, deeds, agreements, instruments, corporate financials and other documents pertinent to the transaction, and copies of relevant foreign laws applicable to the transaction. Certified English translation of all relevant documents (if not in English).
  - Factual analysis: The request must be accompanied by an analysis of facts and their bearing on the issue or issues.
  - Statement: The request must state whether, to the best of the knowledge of both the taxpayer and the taxpayer's representatives, the same issue is addressed in any return of the taxpayer, a related taxpayer within the meaning of § 267, or of a member of an affiliated group of which the taxpayer is also a member within the meaning of § 1504, or any predecessor, and whether the same issue is/was examined by IRS Appeals, a Federal agency, or a Federal court.
  - Statement: The request must include a statement regarding whether same or similar issue was previously ruled on or whether a request involving the issue was submitted or is currently pending.
  - Statement: Statement of both supporting and contrary authorities. What law/rules support/oppose the request?
  - Statement: Statement identifying pending legislation.
  - Penalties of perjury statement
  - Statement: Statement identifying information to be deleted from the public inspection copy
  - Other statements may be required based on type of request, see Revenue Procedure 2015-1.





## 2. Private Letter Rulings

### How do you get a Private Letter Ruling (PLR)?: Part 2

- Submit the request timely: In exempt organizations matters, the IRS generally issues letter rulings on proposed transactions or on completed transactions **if the letter ruling request is submitted before the return is filed for the year in which the transaction is completed.** The IRS will not ordinarily issue a letter ruling on a completed transaction if the letter ruling request is submitted after the return is filed for the year in which the transaction is completed.
- Submit the request to the correct place: Original letter ruling requests will be routed to the appropriate Field office (Associate Office) having audit jurisdiction over the taxpayer's return. The submission should be marked "RULING REQUEST SUBMISSION" and sent to:

Internal Revenue Service  
Attn: CC:PA:LPD:DRU  
P.O. Box 7604  
Ben Franklin Station  
Washington, DC 20044
- Submit the correct user fee: VARIES. See Appendix A, p.79-83.
- Consider submitting a Form 2848 for Authorized Representative
- Signature and date – wet signature by taxpayer or authorized representative is required
- Submit the original AND AT LEAST 1 COPY. If there are multiple issues, increase the number of copies by the number of issues.
- Respond to requests for additional information in a timely manner (within 21 days).



## 2. Private Letter Rulings

### Can you ask for a particular conclusion in a Private Letter Ruling (PLR)?:

- YES!
- A taxpayer who requests a particular conclusion on a proposed transaction may **make the request for a letter ruling in two parts**. This type of request is referred to as a “two-part” letter ruling request. The first part must include the complete statement of facts and related documents described in previous slides. The second part must include a summary statement of the facts the taxpayer believes to be controlling in reaching the conclusion requested.
- If the IRS accepts the taxpayer’s statement of controlling facts, it will base its letter ruling on these facts. Ordinarily, this statement will be incorporated into the letter ruling. The IRS reserves the right to rule on the basis of a more complete statement of the facts and to seek more information in developing the facts and restating them.
- Taxpayers may not use the two-part procedure if it is inconsistent with other procedures, such as those dealing with requests for permission to change accounting methods or periods, applications for recognition of exempt status under § 501(a) or § 521, or requests for rulings on employment tax status.
- After the IRS has resolved the issues presented by a letter ruling request, an IRS representative may request that the taxpayer submit a proposed draft of the letter ruling to expedite the issuance of the ruling.



## 2. Private Letter Rulings

Can you ask for an expedited Private Letter Ruling (PLR)?:

- YES!
- But...expedited handling is granted only in rare and unusual cases.
- A taxpayer with a compelling need to have a request processed ahead of requests received before it may request expedited handling. This request must explain in detail the need for expedited handling. The request for expedited handling must be made in writing, preferably in a separate letter included with the request for the letter ruling or determination letter or provided soon after its filing. If the request for expedited handling is contained in the letter requesting the letter ruling or determination letter, the letter should state at the top of the first page **“Expedited Handling Is Requested. See page \_\_\_ of this letter.”**
- Whether a request for expedited handling will be granted is within the IRS’s discretion. Generally, the standard is: “when a factor outside the taxpayer’s control creates a real business need to obtain a letter ruling before a certain date in order to avoid serious business consequences.” Examples include court or governmental agency deadlines or the avoidance of a hostile takeover.



# Ask for Official Guidance

When in doubt, ask for guidance!: Avoiding missteps with your State Attorney General

- **Request a formal letter determining exemption from solicitation filings** (most states have statutory exemptions) – you can request an exemption letter
- **Attorney General Opinions:**
  - An attorney general opinion is a written interpretation of existing law. Attorney general opinions cannot create new provisions in the law or correct unintended, undesirable effects of the law. Attorney General opinions do not necessarily reflect the Attorney General's personal views, nor does the attorney general in any way “rule” on what the law should say. Furthermore, attorney general opinions cannot resolve factual disputes.
  - Usually, the Attorney General is prohibited by statute from giving a written opinion to anyone other than an authorized requestor. Frequently, authorized requestors include (but check in your state):
    - the governor, auditor, or other executive officer
    - the head of a department of state government or a state board
    - a regent or trustee of a state educational institution
    - a member of the State Legislature
    - the attorney or a member of a local government or joint powers authority
    - a district or county attorney

A person other than an authorized requestor who would like to request an attorney general opinion may ask an authorized requestor to submit the question to the Attorney General. However, the Attorney General can't give legal advice to private parties.

- While these opinions do not generally have legally binding effect as would a court decision, they are helpful in guiding the actions of public officials and are often accorded substantial deference by the courts.



# Charity Regulation

## When in doubt, call for help:

- An attorney experienced in nonprofitland
- A CPA experienced in nonprofitland
- IRS/AGO/government agent and/or supervisor – request a meeting or a phone call

# Thank you!!!



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