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## **Anatomy of an IRS Audit of a Public Charity**

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# ANATOMY OF AN IRS AUDIT OF A PUBLIC CHARITY<sup>1</sup>

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## I. WHAT ARE THE TYPES OF IRS AUDITS OF PUBLIC CHARITIES?

**A. AUDIT VERSUS EXAMINATION:** The terms “audit” and “examination” are synonymous. In the context of an organization exempt from federal income taxation under section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the “Code”), and classified as a public charity (hereinafter, a “public charity”), an audit or examination involves a review by the Internal Revenue Service (the “IRS”) of the books and records of the public charity to determine its tax liability and to determine whether the public charity still qualifies for tax-exempt status.<sup>2</sup> There are two kinds of IRS audits of a public charity: (1) a field audit and (2) an office/correspondence audit.<sup>3</sup>

**B. FIELD AUDIT:** A field audit is a more complex process where the audit is usually conducted at the public charity's offices (or, less often, at an IRS field office) by one or more IRS examiners.<sup>4</sup> There are two types of field audits: (1) Exempt Organizations Team Examination Program (TEP) examinations, which are audits of large, complex exempt organizations (generally having assets or income of \$250 million or more) involving a team of IRS examiners led by a team coordinator, and (2) Exempt Organizations General Program examinations, which are field audits of smaller exempt organizations focused on just one issue and conducted by one IRS examiner under the supervision of a group manager.<sup>5</sup> The process for a field audit is explained in further detail in Section IV of this outline.

**C. OFFICE/CORRESPONDENCE AUDIT:** An office/correspondence audit (a “correspondence audit”) is generally “limited in scope” and focuses “on only one or two items on a return.”<sup>6</sup> A correspondence audit is generally conducted through correspondence and/or over the telephone between the IRS examiner and the public

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<sup>2</sup> See IRS Fact Sheet 2008-14, *Examination and Compliance Check Processes for Exempt Organizations* (February 2008) (“FS 2008-14”), available at <https://www.irs.gov/uac/examination-and-compliance-check-processes-for-exempt-organizations>.

<sup>3</sup> See IRS Website page, *Charity and Nonprofit Audits* (Last Reviewed or Updated Nov. 8, 2016), available at <https://www.irs.gov/charities-non-profits/exempt-organizations-audit-process>.

<sup>4</sup> See FS 2008-14.

<sup>5</sup> See *id.*

<sup>6</sup> See *id.* See also I.R.M. § 4.75.9.2.4.1(1) (stating that office/correspondence audits typically deal with no more than three or four issues) and I.R.M. § 4.75.27. The Internal Revenue Manual is available at <https://www.irs.gov/irm/>.

charity and its representatives.<sup>7</sup> If the public charity is non-responsive or issues in the audit become more complicated, the IRS may require the charity to bring records to an IRS office.<sup>8</sup> In addition, a correspondence audit may evolve into a field audit if issues become more complex.<sup>9</sup>

**D. NOT AN IRS AUDIT—COMPLIANCE CHECK:** A compliance check is not an IRS audit, because it does not relate to determining a public charity's tax liability for a particular period. Instead, a compliance check is described by the IRS as "a review conducted by the IRS to determine. . . whether an organization is adhering to record keeping and information reporting requirements [and] whether an organization's activities are consistent with their stated tax-exempt purpose."<sup>10</sup> A compliance check is similar to a correspondence audit as it involves interaction with the IRS though correspondence or telephone. A compliance check often centers around a review of information and forms that a public charity is required to file or maintain (*e.g.*, Form 990, Form 990-T, Form 940 or Form 941).<sup>11</sup> During the compliance check process, the public charity should expect to be asked questions about (1) specific items on a return filed with the IRS or (2) whether particular activities are consistent with its stated tax-exempt purposes.<sup>12</sup> The public charity generally will not be asked to have its books and records examined by the IRS and will not be asked questions about its tax liability.<sup>13</sup> That being said, a compliance check may lead to an IRS audit.<sup>14</sup> A public charity may be subject to more than one compliance check for a particular tax year "if facts and circumstances warrant."<sup>15</sup>

## II. WHAT COULD TRIGGER AN IRS AUDIT OF A PUBLIC CHARITY?

**A. REFERRALS:** Any person may file a complaint with the Exempt Organizations Examinations Division, including by completing IRS Form 13909 (Tax-Exempt Organization Complaint (Referral) Form), to report that the activities or operations of a tax-exempt organization are inconsistent with its tax-exempt status; the complaint in turn may trigger an IRS audit. The complaint can be sent to the Exempt Organizations Examination Division at the following address: IRS EO Referrals,

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<sup>7</sup> See FS 2008-14.

<sup>8</sup> See *id.*

<sup>9</sup> See *id.*

<sup>10</sup> See IRS Publication 4386, *Compliance Checks – Examination, Audit or Compliance Check?* (Revised Apr. 2006) ("IRS Publication 4386"). See also I.R.M. § 4.75.9.2.2(1).

<sup>11</sup> See *id.*

<sup>12</sup> See FS 2008-14.

<sup>13</sup> See *id.*

<sup>14</sup> See *id.*

<sup>15</sup> See IRS Publication 4386.

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