

Internal Revenue Service
Director, Exempt Organizations

Department of the Treasury
P.O. Box 2508 - TE/GE
Cincinnati, OH 45201

Date: OCT 10 2001

Employer Identification Number:
[REDACTED]

Person to Contact - I.D. Number:
[REDACTED]

Contact Telephone Numbers:

[REDACTED] Phone

[REDACTED] FAX

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under the provisions of section 501(c)(4) of the Internal Revenue Code of 1986 and its applicable Income Tax Regulations. Based on the available information, we have determined that you do not qualify for the reasons set forth on Enclosure I.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code. However, we have concluded that you do not qualify under another subsection.

As your organization has not established exemption from Federal income tax, it will be necessary for you to file an annual income tax return on Form 1041 if you are a Trust, or Form 1120 if you are a corporation or an unincorporated association.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

You have the right to protest this proposed determination if you believe it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues." The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office or, if you request, at any mutually convenient District Office. If you are to be represented by someone who is one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

If we do not hear from you within the time specified, this will become our final determination.

Sincerely,

Steven Miller

Director, Exempt Organizations

Enclosures:
Enclosure I
Form 6018
Publication 892
Envelope

[REDACTED]
[REDACTED]

Enclosure I
Reasons for Adverse Determination

You were incorporated in [REDACTED] as a non-profit corporation under the statutes of [REDACTED]. According to your Articles of Incorporation, the purposes for your organization are to "hold title to the municipal liquor store heretofore operated by [REDACTED], operating the same, collecting income therefrom and turning over the entire amount thereof, less expenses, to [REDACTED] or said [REDACTED]." A letter attached to your Articles of Incorporation within your application indicates that the store was previously operated by the city, until the operation of such facilities was ruled unconstitutional in [REDACTED], thus the creation of your organization.

Your Bylaws indicate that membership in your organization is limited to a [REDACTED]-member board of directors. The Bylaws indicated that the initial board of directors would be the same initial directors as stated in your Articles of Incorporation. Any vacancies occurring due to death, resignation, removal from the City, or otherwise, shall be filled by the remaining directors. Your application indicates that board members are paid at a rate of \$ [REDACTED] per meeting, and attend [REDACTED] meetings per year. No indication is made that the city or [REDACTED] has any role or voice in determining the makeup of your board of directors. In correspondence to us in response to our letter [REDACTED], you indicate that the city has influence in your operations by allowing you to have a gaming license, a liquor license, and allowing you to operate.

Your activities began in [REDACTED] with the operation of your off site liquor sales. In [REDACTED], you began on site liquor sales. You indicate that your liquor sales are conducted by paid employees, and that liquor is priced and sold so as to generate a profit. In [REDACTED], you indicate that you bought a building to be used for rental purposes. The building is attached to your liquor store, and is leased out to a local clothing shop at going commercial rates. In [REDACTED], you began gaming activities with the sales of pull-tabs. Pull-tabs are sold at your liquor establishment, and at three unrelated off site locations. You also conduct bingo in your own facilities once a week. Gaming activities are under the direction of your treasurer/gaming manager, who is compensated for his/her efforts, in compliance with [REDACTED] gaming

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 statutes. You were declared exempt from State Income Tax in ██████. Since the time of your formation, you have given net profits to help build a local hospital for the community, to help maintain said hospital, to assist the city with various public/municipal projects, and to local schools and other charitable organizations. Your application indicates that upon dissolution of your organization, any remaining assets will be given to charities or the local hospital. There is no dissolution provision in your Articles of Incorporation.

Your gross revenues have been derived from both on and off site liquor sales, as well as from gaming and rental income.

On page 3 of Form 1024, in response to questions 4 and 5, you indicate that you are not the outgrowth of, or successor to any other organizations, and that you do not plan to be connected, affiliated, or related to any other organizations in the future.

Your financial statements, which are outlined on page 5 of Form 1024, show that over the past four fiscal years, which include the periods from ██████████ through ██████████, you list gross revenues derived from carrying out your exempt purpose of just over \$██████████. You also list approximately \$██████████ in investment income for this period. Expenses attributable for carrying out your exempt purposes during this time were at \$██████████. Your contributions to the hospital, city, and other charitable organizations during this period were \$██████████. You show \$██████████ in depreciation and depletion expenses. Though you indicate that you have paid employees, you do not list any salaries or compensation expenses in support of lines 13 and 14 on page 5 of Form 1024. It is determined that these expenses were included in your expenses attributable to carrying out your exempt purposes.

Section 501(c)(4) of the Code provides for the exemption from Federal income tax of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

Section 1.501(c)(4)-1 of the Income Tax Regulations provides that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization is not operated primarily for the promotion of social welfare if its primary activity is carrying on a business with the general public in a manner similar to organizations that are operated for profit.

IRC 502 provides that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under IRC 501 on the ground that all of its profits are payable to one or more organizations exempt under IRC 501.

IRC 502 states as follows:

(a) General Rule: An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt from taxation under section 501 on the ground that all of its profits are payable to one or more organizations exempt from taxation under section 501.

(b) Special Rule: For purposes of this section, the term "trade or business" shall not include --

(1) the deriving of rents which would be excluded under section 512(b)(3), if section 512 applied to the organization,

(2) any trade or business in which substantially all the work in carrying on such trade or business is performed for the organization without compensation, or

(3) any trade or business which is the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions.

Revenue Ruling 73-164, 1973-1 C.B. 223, describes a church controlled commercial printing corporation whose business profits are payable to the church, but which has no other significant charitable activity. Rev. Rul. 73-164 recognizes that the organization is organized and operated for charitable purposes by virtue of the fact that the beneficial use of its assets is effectively dedicated to exclusively charitable objects and thereby qualifies under IRC 501(c)(3), in the absence of IRC 502. However, because its income is required to be turned over to the church, the revenue ruling concludes that IRC 502 precludes exemption.

Revenue Ruling 68-46, 1968-1, C.B. 260 indicates that a war veterans organization does not qualify for exemption from Federal income tax under section 501(c)(4) of the Internal Revenue Code of 1954 where it is primarily engaged in renting a commercial building and operating a public banquet and meeting hall having bar and dining facilities. The organization is composed of war veterans of the armed services of the United States formed to conduct veterans' programs and other benevolent, welfare, patriotic, and civic activities. The organization owns two buildings. One is an office building rented to commercial tenants. The other contains meeting rooms and club facilities for the organization. However, the larger part of the latter building is comprised of a large hall available for rental by the general public. By the use of movable partitions, five meeting rooms can be used simultaneously. Food and bar catering services are provided. Two ultramodern kitchens are used for serving meals. These facilities are

in daily use by nonmember groups. The organization employs a manager, assistant manager, and a full time staff to operate its dining room, bar facilities, and the hall. Extra kitchen help, waiters, and bartenders are frequently hired on a part-time basis. Income from rental and catering services constitutes the major portion of the organization's gross receipts. Although the organization carries on veterans' programs and other benevolent, welfare, patriotic, and civic activities, it has been determined that the organization's business activities relating to the rental of the office building and meeting room space and the food and bar catering services exceeded all its other activities. Inasmuch as the organization's social welfare program is not its primary activity, the organization is not exempt from Federal income tax under section 501(c)(4) of the Code.

Your organization shares similarities with the organization described in Revenue Ruling 68-46, though we agree you are not a veterans organization. Your organization's primary activity is that of conducting on and off site liquor sales. You use paid employees to dispense your regular inventory. These operating characteristics are also similar to an organization that conducts a regular commercial business. While you turn at least [redacted] percent of your gross revenues, and over [redacted] of your net income over to other charitable organizations, this is not your primary activity/purpose, and will preclude your exemption from Federal Income Tax under section 501(c)(4) of the Internal Revenue Code. It appears that you meet the characteristics of a feeder organization as described in section 502 of the Code. You also do not show any means of direct control over your organization by the city, the hospital, or any of the other charitable organizations to which you provide support.

Accordingly, you do not qualify for exemption under section 501(c)(4) of the Internal Revenue Code.