



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
TE/GE: EO Examinations
625 Fulton Street, Room 503
Brooklyn, NY 11201

**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

Number: **200634044**
Release Date: 8/25/2006
Uil: 501.10-01

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear _____ :

This is a final determination regarding your exempt status under section 501(c)(10) of the Internal Revenue Code (IRC). Recognition of your exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(10) is retroactively revoked to because it is determined that you have not established that you are observing the conditions required for the continuation of an exempt status.

We previously provided you a report explaining the proposed revocation of your tax-exempt status. At that time, we informed you of your right to contact the Taxpayer Advocate, as well as your appeal rights. By signing Form 6018-A, *Consent to Proposed Action*, you indicated that you accept our determination to revoke your organization's exempt status.

We have determined that you fail to qualify for exempt status under any other subsection of IRC 501(c).

You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for all years beginning We have secured Form 1120 for years ended and

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter.

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez
Director, EO Examinations



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY

Internal Revenue Service

TE/GE: EO

3730 Elizabeth Ave.

Independence, MO 64057

UIL: 501.10-01

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear

We have enclosed a copy of our report of examination explaining why we believe an adjustment of your organization's exempt status is necessary.

If you do not agree with our position you may appeal your case. The enclosed Publication 3498, *The Examination Process*, explains how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

If you request a conference, we will forward your written statement of protest to the Appeals Office and they will contact you. For your convenience, an envelope is enclosed.

If you and Appeals do not agree on some or all of the issues after your Appeals conference, or if you do not request an Appeals conference, you may file suit in United States Tax Court, the United States Court of Federal Claims, or United States District Court, after satisfying procedural and jurisdictional requirements as described in Publication 3498.

You may also request that we refer this matter for technical advice as explained in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*. If a determination letter is issued to you based on technical advice, no further administrative appeal is available to you within the IRS on the issue that was the subject of the technical advice.

If you accept our findings, please sign and return the enclosed Form 6018, *Consent to Proposed Adverse Action*. We will then send you a final letter modifying or revoking exempt status. If we do not hear from you within 30 days from the date of this letter, we will process your case on the basis of the recommendations shown in the report of examination and this letter will become final. In that event, you will be required to file Federal income tax returns for the tax period(s) shown above. File these returns with the Ogden Service Center within 60 days from the date of this letter, unless a request for an extension of time is granted. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

You 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 that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have 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:

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,

R. C. Johnson
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Form 6018
Report of Examination
Envelope

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit 1
Name of Taxpayer		Year/Period Ended

Issues:

- 1. Whether the organization is a domestic fraternal society, order, or association, operating under the lodge system, the net earnings of which are devoted exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes.**
- 2. Whether the organization's activities meet the exempt purpose of an organization exempt from tax under Internal Revenue Code section 501(C)(10)?**
- 3. Whether the sales of pulltabs by the organization are subject to wagering and excise taxes?**

Issue 1:

Facts:

, also doing business as Bar & Grill, in
is a bar and grill open to the general public. The organization is a subordinate lodge of The
with between 25 and 45 members.

The bar and grill was acquired by the current owner, Mr. , in with the final purchase occurring in at fair market value. The acquisition price was for an on going business that was a subordinate lodge of the . The is an organization recognized as exempt under Internal Revenue Code section 501(c)(10). The purchase of the business included an existing building and all associated property of the business. All of the business's assets belong to . The examination of the organization's Form 990 for and and a review of the organization's Balance Sheets for and showed that the organization did not have any property assets or liabilities except for a small equipment purchase in in the amount of \$2,229.35.

The previous owner had become affiliated with the in and was recognized as a lodge or subordinate under the lodge system. continued the affiliation with the parent organization through a registration change filed with the Missouri Secretary of State. Upon completing the registration change with the Missouri Secretary of State the current owner started having monthly meetings for the members and maintaining Minutes of these meetings.

The examination of the and Form 990's and the review of the and Income Statements showed that there were no membership dues receipts. The subordinate lodge has not retained any membership records. These records were requested from the parent lodge by the President and by the Service but were not provided. The President stated that the membership fees are paid by the subordinate lodge to the national headquarters in addition to an annual participation fee. The members receive no benefits from the organization and the members have no common ties or objectives as reason for their membership.

Mr. , the owner, is the President of the Board of Directors. The three members of the Board of Directors listed on the Missouri Secretary of State's Annual Registration Report are the three reported members of the Board of Directors for the parent organization. The three Board of Directors members have not attended any meetings conducted by the subordinate lodge.

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The organization did not make any disbursements in _____ or _____ for religious, charitable, scientific, literary, educational or fraternal purposes. The organization's Constitution and Bylaws dated _____ do not specify that all earnings must be devoted to religious, charitable, scientific, literary, educational, and fraternal purposes.

A review of the organization's Income Statements for _____ and _____ showed that approximately 30% of the income was attributed to member sales and 70% of the sales were to nonmembers. According to the President, the sales are accounted for as member or nonmember at the time of sale on the business's cash register. The organization does not maintain any records, such as a sign in sheet, with which to verify this percentage. The income reported on the organization's _____ Form 990 consists of food and liquor sales and a small percentage of revenue from jukebox and video game sales. The income reported for _____ included these same revenue sources in addition to income from the sale of pulltabs.

The parent organization's Constitution and Bylaws state that the organization's purpose is "to promote fellowship among all living beings, respectfully, to encourage the elimination of prejudice and help unify divergent groups in the overall interest of American democracy, to orientate our youth with full knowledge of responsibilities as well as privileges of citizenship through the wisdom of our seniors, to assist the underprivileged and well deserving by maintenance of sponsoring educational opportunities and by providing monetary grants and awards toward their wellbeing overall, to fully support the effort of "Drug Free America", to encourage compassion for every fellow man, woman and child in distress and/ or deserving.)"

Law:

Internal Revenue Code subsection 501(c)(10) provides an exemption for domestic fraternal societies, orders, or associations, operating under the lodge system, the net earnings of which are devoted exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes, and which do not provide for the payment of life, sick, accident, or other benefits.

Income Tax Regulation section 1.501(c)(10)-1. provides that an organization will qualify for exemption under section 501(c)(10) if it is a domestic fraternal beneficiary society order, or association, described in section 501(c)(8) and the regulations thereunder except that it does not provide for the payment of life, sick, accident, or other benefits to its members, and devotes its net earnings exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes.

Internal Revenue Code section 501(c)(8) provides an exemption from taxation for fraternal beneficiary societies, orders, or associations operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system and providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents..

In National Union v. Marlow 374 F. 775, 778 (1896) a fraternal beneficial society was defined as one whose members have adopted the same, or a very similar calling, avocation, or profession, or who are working in union to accomplish some worthy object, and who for that reason have banded themselves together as an association or society to aid and assist one another, and to promote the common cause. The term "fraternal" can properly be applied to such an association, for the reason that the pursuit of a common object, calling, or profession usually has a tendency to create a brotherly feeling among those who are thus engaged.

The court in Polish Army Veterans Post 147 v. Commissioner, 24 T.C. 891, reversed on other grounds, 236 F.2d 509 (3rd Cir. 1956) concluded that an organization had not established its exemption as a fraternal beneficiary society because members lacked a common tie: To qualify for the exemption an organization must be fraternal.... Here only the active members, comprising less than 10 per cent of the

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Explanation of Items		
Name of Taxpayer		Year/Period Ended

total membership of the Post, had a common tie. They, of course had the bond of having formerly served in the Polish Army. But approximately 90 per cent of the total membership of the Post were social members who were not ex-members of the Polish Armed Forces and who ... had nothing in common with the active members or with each other. An organization cannot be classed as fraternal where the only common bond between the majority of the members is their membership in that organization.

Fraternal Order of Civitans v. Commissioner, 19 T.C. 240 (1952) provided that the requirement of common ties and objectives is not satisfied merely by a recitation of such purposes in the association's constitution or bylaws. It is necessary that the stated purposes be implemented or accomplished by specific acts. The Tax Court denied exemption to an organization whose constitution called for, among other things, the promotion of civic enterprises in the community. It engaged in no civic or charitable activities during the period under review.

The court in Western Funeral Benefit Association v. Hellmich, 2 F.2d 367 (E.D. Mo. 1924), stated that "by the 'lodge system' is generally understood as an organization which holds regular meetings at a designated place, adopts a representative form of government, and performs its work according to ritual."

Government's Position:

The organization is not a domestic fraternal society because the members do not have a common tie or objective. The only common bond between the members is their membership in the organization. The members do not possess a similar calling, avocation, or profession, and are not working in unison to accomplish some worthy object through their actions.

The organization is not operating under the lodge system. The subordinate lodge is a member of the parent organization through the payment of dues and an affiliation fee. The annual membership dues are paid by the subordinate lodge, not the members. The term "membership dues" implies that each member pays a fee for membership because they place a value on their association with the organization and that there are rights, privileges or benefits associated with membership. The organization does not have a set meeting schedule and there are no rituals associated with the meetings. The organization does not have a representative form of government because the members have no voice or voting rights in the business operation of the organization or the net earnings expenditures and the officers have no authority to conduct business on behalf of the organization and they are not selected or elected by the membership.

The organization does not devote its net earnings exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes. The current owner purchased an ongoing business with the intent to profit on the investment. All assets and net earnings of the organization belong to the owner. Upon the change in ownership, the prior owner retained the organization's net earnings from the sale of the assets and goodwill of the organization. The manner in which the organization was purchased illustrates that the intent of the owners is to operate a for profit business with the objective of increasing their own net worth.

Conclusion:

The organization is not a domestic fraternal society operating under the lodge system, the net earnings of which are devoted exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes. The organization does not qualify for exemption under section 501(c)(10) of the Internal Revenue Code and their tax exempt status should be revoked

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Issue 2: Do the organization's activities meet the exempt purpose of an organization exempt from tax under Internal Revenue Code section 501(C)(10)?

Facts:

A review of the organization's Minutes of the monthly meetings established that the organization's activities in were a Halloween party, a New Years party and a Christmas canned food drive for Meals on Wheels for which 97 cans of food were collected. In the organization hosted a surprise birthday party and a pool tournament which was in lieu of a Cowboys and Indians party and organized a chili cook-off contest. All of the activities were open to the general public and the organization did not conduct any activities which were exclusive to the members.

A review of the organization's Form 990 for and showed that there were no program service accomplishments. The organization's Income Statement showed that all expenses were for the operation of the bar and restaurant. There were no exempt purpose expenditures.

The organization's purpose as stated in their Constitution and Bylaws is provided in the Fact section under Issue 1.

Law:

Fraternal Order of Civitans v. Commissioner, 19 T.C. 240 (1952) provided that the requirement of common ties and objectives is not satisfied merely by a recitation of such purposes in the association's constitution or bylaws. It is necessary that the stated purposes be implemented or accomplished by specific acts. The Tax Court denied exemption to an organization whose constitution called for, among other things, the promotion of civic enterprises in the community. It engaged in no civic or charitable activities during the period under review.

Government's Position:

The organization's activities do not meet the purpose of an organization exempt under Internal Revenue Code section 501(c)(10). The organization did not engage in any activities during and to accomplish the stated purpose of the organization. The operation of a bar and grill open to the general public and in direct competition with similar businesses that are for-profit is not an exempt purposes activity.

Social and recreational activities have traditionally been considered a type of activity in which fraternal organizations engage along with other purely fraternal activities. The operation of a bar and restaurant is an acceptable social and recreational endeavor when the fraternal members' participation has a substantial causal relationship to the exempt purpose of the organization. However, since the organization does not conduct any other fraternal activities, and there are only 25 to 45 members, the operation of a bar and grill for the purpose of serving the general public is not an acceptable social activity because it can not be deemed to be fraternal for the members.

Based on a review of the organization's Income Statement, the provided expense invoices, the Form 990's for and , and the Minutes, it was determined that the primary activity of the organization is the operation of a bar and grill open to the general public.

Conclusion:

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit 1
Name of Taxpayer		Year/Period Ended

The organization's activities do not meet the purpose of an organization exempt from tax under section 501(c)(10) of the Internal Revenue Code and their tax exempt status should be revoked.

Issue 3:

Facts:

The organization started selling pulltabs in . The organization did not file Form 730, Monthly Tax Return for Wagers, and Form 11-C, Occupation Tax and Registration Return for Wagering, with the Internal Revenue Service for their sales of pull-tabs.

Law:

Internal Revenue Code section 4401 imposes an excise tax on each person engaged in the business of accepting wagers equal to 0.25 percent on the amount of all wagers placed with him.

Internal Revenue Code section 4411 imposes a special tax of \$500 per year to be paid by each person who is liable for the tax imposed under Internal Revenue Code section 4401 or \$50 per year if the wagers are authorized under State law.

Internal Revenue Code section 4421 and Treasury Regulation section 44.4421-1(a) provide that a wager is a bet made on a sports event or contest placed with a person in the business of accepting wagers; placed in a wagering pool on a sports event or contest, if such pool is conducted for profit; and placed in a lottery conducted for profit.

Revenue Ruling 57-258, 1957-1 C.B. 418, holds that a pull-tab game is essentially nothing more than a type of punch board game that falls within the meaning of the term "lottery" as used in Internal Revenue Code section 4421(2) and, as such, is subject to the wagering taxes imposed by sections 4401 and 4411 of the Internal Revenue Code.

Treasury Regulation section 44.4412-1 provides that every person required to pay the special tax imposed by section 4411 shall register and file a return on Form 11-C.

Treasury Regulation section 44.4901-1(a) provides that no persons shall engage in the business of accepting wagers subject to the tax imposed by section 4401 until he has filed a return on Form 11-C and paid the special tax imposed by section 4411. Likewise, no person shall engage in receiving wagers for or on behalf of any person engaged in the business of accepting wagers until he has filed a return on Form 11-C and paid the special tax imposed by section 4411. The tax year begins July 1 and ends June 30 of the following calendar year.

Treasury Regulation subsection 44.6011(a)-1 provides that every person required to pay the tax on wagers imposed by section 4401 of the Code shall make a return on Form 730 in accordance with the instructions and regulations for each month whether or not liability has been incurred.

Treasury Regulation subsection 44.6071-1 provides that the Form 730 shall be filed on or before the last day of succeeding month for which the return is being filed and the Form 11-C shall be filed on or before July 1 for the one year period starting on July 1.

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Rev. Rul. 77-51, 1977-1 C.B. 346, holds that in view of the enactment of IRC 4420, the delinquency and fraud penalties imposed by IRC 6651 and 6653 (now IRC 6663) may be assessed and collected for failure to file wagering Forms 730 and 11-C and pay the required taxes.

Government's Position:

The organization is required to file Form 11-C and Form 730 and is liable for the excise and special taxes. Also, the organization's employees, including the owner, may not sell pulltabs unless they file the Form 11-C with the Service. The organization must maintain accurate records detailing the pull tab sales for each month. The organization did not show reasonable cause for failing to file and pay the required forms and taxes and is liable for the penalties.

Conclusion:

The organization must file the Form 730, Monthly Tax Return for Wagers, and Form 11-C, Occupation Tax and Registration Return for Wagering, with the Internal Revenue Service for their sales of pull-tabs.

Conclusion Summary:

The organization is not a domestic fraternal society operating under the lodge system; the organization does not devote its net earnings exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes; and the organization's activities do not meet the purpose of an organization exempt from tax under section 501(c)(10) of the Internal Revenue Code. Consequently, the organization's exempt status is being revoked effective

The organization must file the Form 730, Monthly Tax Return for Wagers, and Form 11-C, Occupation Tax and Registration Return for Wagering, with the Internal Revenue Service for their sales of pull-tabs.

The organization does not qualify for exemption under 501(c)(7) of the Internal Revenue Code because the organization receives more than 15 percent of its gross receipts from non-members on a continuous and recurring basis. The organization does not qualify for exemption under 501(c)(4) of the Internal Revenue Code because it is not an organization operated primarily for the promotion of social welfare whose primary activity is operating a social club for the benefit, pleasure, or recreation of its members. The organization is carrying on a business with the general public in a manner similar to organizations which are operated for profit

I am requesting that you file Forms 1120 for the tax years ending _____ and _____ if you agree with my recommendation to revoke the exempt status of your organization. Please mail the returns, along with Form 6018-A, to me so that I may process them.

I am also requesting that you file the Forms 11-C for _____ and _____ and the Forms 730 for _____ through _____. It is not in the government's best interest to collect the wagering taxes due on the Form 730 for the years under examination due to the de minimis tax liability. The forms and the instructions for completing the forms are on the IRS web site at <http://www.irs.gov/formspubs/index.html>

If the organization does not agree with the recommendation to revoke their exempt status please contact the agent at your earliest convenience to discuss the reasons that you think that your exempt status should be retained.