



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE
Attn: Mandatory Review, MC 4920 DAL
1100 Commerce Street
Dallas, TX 75242

501.19-00

Date: 4/30/2010

Release Number: **201035035**

Release Date: 9/3/10

LEGEND

ORG = Organization name XX = Date Address = address

ORG
ADDRESS

Person to Contact/ID Number:
Contact Numbers:
Voice:
Fax:

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear

In a determination letter dated November 19XX, you were held to be exempt from Federal income tax under section 501(c)(19) of the Internal Revenue Code.

Based on recent information received, we have determined you have not operated in accordance with the provisions of section 501(c)(19) of the Code. Accordingly, your exemption from Federal income tax is revoked effective March 1, 20XX. This is a final adverse determination letter with regard to your status under section 501(c)(19) of the code.

We previously provided you a report of examination explaining why we believe revocation of your exempt status is necessary. At that time, we informed you of your right to contact the Taxpayer Advocate, as well as your appeal rights. On September 14, 20XX, you signed Form 6018-A, *Consent to Proposed Action*, agreeing to the revocation of your exempt status under section 501(c)(19) of the Code.

You are therefore required to file Form 1120, *U.S. Corporation Income Tax Return*, for the years ended December 31, 20XX with the Ogden Service Center. For future periods, you are required to file Form 1120 with the appropriate service center indicated in the instructions for the return.

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 contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely,

Nanette M. Downing
Director, EO Examinations



DEPARTMENT OF THE TREASURY
Internal Revenue Service
TE/GE EO Examinations
1122 Town and Country Commons Room 128
Chesterfield, MO 63017-8293

June 10, 2010

ORG
ADDRESS

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,

Sunita B. Lough
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: Form 6018-A
Name of Taxpayer ORG		Year/Period Ended 12/31/20XX

LEGEND

ORG = Organization name XX = Date Address = address City = city
State = state CO-1 = 1st company

Issue:

1. Whether the primary activity of ORG, doing business as "CO-1", is the operation of a commercial bar open to the general public. If so, should ORG's exemption under IRC Section 501(a) as an organization described in Section 501(c)(19) be revoked, effective January 1, 20XX?
2. Whether ORG's, doing business as "CO-1", records are inadequate under Section 6033. If so, should ORG's exemption under IRC Section 501(a), as an organization described in Section 501(c)(19) be revoked, effective January 1, 20XX?

Facts:

1. The ORG (hereinafter referred to as ORG) is currently exempt under Section 501(c)(19) of the Code as a subordinate organization under Group Ruling Number (GEN) 9509, which was issued to ORG Headquarters (hereinafter referred to as HQ) 501(c)(19) Organization (Group Ruling Parent) in 19XX. The ORG opened for business in March 20XX under the HQ. ORG found out about the organization through a friend who also owns a ORG' Organization.
2. The organization's Articles of Incorporation, dated 20XX, shows that the organization was formed to support all veterans and their families.
3. The organization does not have its own bylaws. ORG provided the Constitution & Bylaws of the HQ, which is what the subordinate organization uses. These bylaws have as their stated purposes "the uniting fraternally of veterans and the families of veterans in order to better the lives of all veterans and their families and to assist with any difficulties encountered by them. These purposes include but are not limited to the following:
 - Help fellow veterans and their families receive the benefits for which they are entitled;
 - Find employment for veterans and their families;
 - Help the homeless veterans find housing and re-adjust to civilian life;
 - Carry on programs to perpetuate the memory of deceased veterans and members of the armed forces, and to comfort their survivors;
 - Sponsor or participate in activities of a patriotic nature;
 - Provide social and recreational activities for its members;
 - Assist the disabled and needy war veterans and their dependents;
 - Promote awareness of the prisoners of war and the missing in action issues;
 - Promote the general welfare and prosperity of all ORG corporations;

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➤ Present and support the purposes of ORG before the public and the government”.

4. The ORG operates a cash business (bar) at Address, City, State. The building’s facade exhibits signs stating “ORG” and “CO-1”. The facility consists of approximately 1000 sq. ft. of space. There is a full service bar and kitchen (but no separate dining room), pool tables, bowling video games, and a juke box.

5. The ORG’s facilities are open 7 days a week, including holidays. Its hours are Monday through Sunday 11 AM to 1:30AM. The kitchen is open from 11AM until 1 AM daily. It is freely open to both members and nonmembers (general public). The ORG averages approximately 30 people per day.

6. The ORG, as of December 20XX, had 13 veterans’ members. The ORG pays the headquarters \$ per year in dues. Dues for the members to the ORG are \$ per year. A register is kept for nonmembers to sign in to use the facilities. The ORG is only open to the public for fundraisers based on interview testimony from the president.

7. The ORG does not account for member and nonmember bar/kitchen sales separately. According to the organization, more of the bar/kitchen receipts are from members than from non members.

8. Members and nonmembers are charged the same price for liquor and food. Pop is \$ with free refills; call drinks are \$; well drinks are \$; bottled beer is \$; and draft beer is \$.

9. The ORG stated that it has the following activities:

- a. Quarterly meetings and minutes have to be provided to the HQ organization.
- b. Operation of a bar, kitchen, and pool tables are open to both members and nonmembers.
- c. Provide food and cook outs for the members.
- d. Provide fundraisers for food baskets for the elderly veterans and other fund raisers for veterans’ families in need.
- e. Provide free food to the members daily and the 1st drink is free.
- f. Hold Pool Tournaments with the Red Hat Club Auxiliary in which all of the proceeds go to benefit Veterans

10. The organization solicits donations or gifts from members and nonmembers for veterans.

11. Per the 20XX return, the gross sales of the organization were \$\$\$. The organization’s gross receipts per the audit were \$\$\$. The organization’s expenses for liquor, rent, utilities, taxes, advertising, food, and other services were (after

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examination) \$\$ for the year 20XX. The total donations made for the year 20XX were \$\$.

12. Membership Facts do not show bona fide members.

13. A review of the ORG's activities could not determine the extent of member participation since the organization did not keep adequate records showing member participation vs. nonmember participation.

20XX Activities Breakdown:

Activity	Exempt	Non Exempt	Hours	Revenue	Expenses
Quarterly Member Meetings in which minutes are taken that is sent to the HQ organization.	X			N/A	N/A
Operation of a bar, kitchen, pool tables, and video bowling which primarily services to the public		X	0	\$\$	\$\$
Provide food and cookouts for the members free of charge	X			N/A	Expenses not tracked separately.
Provide Free Food to Members daily.	X			N/A	
Donations claimed:					
St. Patrick's Day	X			N/A	
Golf Classic	X			N/A	
Lockard Kids	X			N/A	
Crane Funeral	X			N/A	
Fish Fry	X			N/A	
Chili Supper	X			N/A	
C.A.D. Dinner	X			N/A	
C.A. Day	X			N/A	
New Year's Eve	X			N/A	
Henry Kraft-glasses	X			N/A	
Bill Maxwell-shrimp	X			N/A	
Midwest Hemophilia Assoc.	X			N/A	\$

Law:

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IRC §501(c)(19) provides for the exemption from federal income tax of a post or organization of veterans of the Armed Forces of the United States if such post or organization is:

- a) organized in the United States or any of its possessions,
- b) at least 75% of the members of which are past or present members of the Armed Forces of the United States and substantially all of the other members of which are individuals who are cadets or are spouses, widows, or widowers of past or present members of the Armed Forces of the United States or of cadets, and
- c) no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(19)-1 of the Income Tax Regulations provides that to be described in Section 501(c)(19) of the Code an organization must be operated exclusively for one or more of the purposes listed in that section. Section 1.501(c)(19)-1(c)(8) of the regulations lists as one of these purposes the provision of social and recreational activities for the organization's members.

Section 1.501(c)(19)-1(c) of the regulations provides that an organization described in section 501(c)(19) of the Code must be operated exclusively for one or more of the following purposes:

- To promote the social welfare of the community as defined in section 1.501(c)(4)-1(a)(2) of the regulations,
- To assist disabled and needy war veterans and members of the United States Armed Forces and their dependents, and the widows and orphans of deceased veterans,
- To provide entertainment, care, and assistance to hospitalized veterans or members of the Armed Forces of the United States,
- To carry on programs to perpetuate the memory of deceased veterans and members of the Armed Forces and to comfort their survivors,
- To conduct programs for religious, charitable, scientific, literary, or educational purposes,
- To sponsor or participate in activities of a patriotic nature,
- To provide insurance benefits for their members or dependents of their members or both, or
- To provide social and recreational activities for their members.

With respect to the membership requirements under Section 501(c)(19) of the code, in Senate Report No. 92-1082, 92nd Cong. 2d Sess., 1972-2 C.B. 713 at 715, Congress stated that "substantially all" means 90 percent. Therefore, of the 25 percent of the members that do not have to be past or present members of the Armed Forces of the United States, 90 percent have to be cadets, or spouses, etc. Thus, only 2.5 percent of a section 501(c)(19) organization's total membership may consist of individuals not mentioned above.

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

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 provision 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 its exempt status.

Section 511(a)(1) of the code states there is hereby imposed for each taxable year on the unrelated business taxable income (as defined in Link section 512) of every organization described in paragraph (2) a tax computed as provided in Section 11. In making such computation for purposes of this section, the term "taxable income" as used in Section 11 shall be read as "unrelated business taxable income".

Section 511(a)(2)(A) of the code states the tax imposed by paragraph (1) shall apply in the case of any organization (other than a trust described in subsection (b) or an organization described in Link Section 501(c)(1) which is exempt, except as provided in this part or part II (relating to private foundations), from taxation under this subtitle by reason of Section 501(a).

Section 512 (a)(1) of the Code states, Except as otherwise provided in this subsection, the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in Section 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in subsection (b).

Section 513(a) of the Code states the term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by Section 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under Section 501 (or, in the case of an organization described in Section 511(a)(2)(B), to the exercise or performance of any purpose or function described in Section 501(c)(3), except that such term does not include any trade or business –

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513(a)(1) in which substantially all the work in carrying on such trade or business is performed for the organization without compensation; or

513(a)(2) which is carried on, in the case of an organization described in Section 501(c)(3) or in the case of a college or university described in Section 511(a)(2)(B), by the organization primarily for the convenience of its members, students, patients, officers, or employees, or, in the case of a local association of employees described in Section 501(c)(4) organized before May 27, 1969, which is the selling by the organization of items of work-related clothes and equipment and items normally sold through vending machines, through food dispensing facilities, or by snack bars, for the convenience of its members at their usual places of employment; or

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

Section 513(c) of the Code provides that "trade or business" includes any activity which is carried on for the production of income from the sale of goods or the performance of services. An activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization.

Income Tax Regulations §1.501(c)(19)-1(c) provides that an organization exempt under §501(c)(19) must be operated exclusively for one or more of the following purposes:

- 1) To promote the social welfare of the community as defined in section 1.501(c)(4)-1(a)(2),
- 2) To assist disabled and needy war veterans and members of the United States Armed Forces and their dependents and widows and orphans of deceased veterans,
- 3) To provide entertainment, care, and assistance to hospitalized veterans or members of the Armed Forces of the United States,
- 4) To carry on programs to perpetuate the memory of deceased veterans and members of the Armed Forces and to comfort their survivors,
- 5) To conduct programs for religious, charitable, scientific, literary, or educational purposes,
- 6) To sponsor or participate in activities of a patriotic nature,
- 7) To provide insurance benefits for their members or the dependents of their members or both, or
- 8) To provide social and recreational activities for their members.

Section 1.6001-1(a) of the regulations in conjunction with section 1.6001-1(c) provides that every organization exempt from tax under section 501(a) of the Code and subject

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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.

Section 1.6001-1(e) of the regulations provides that the books or records required by this section shall be kept at all times available for inspection by authorized internal revenue officer or employees, and shall be retained as long as the contents thereof may be material in the administration of any internal revenue law.

Tax Regulation §1.6033-2(a)(1) states in part that every organization exempt from taxation under section 501(a) shall file an annual information return specifically setting forth its items of gross income, gross receipts and disbursements, and such other information as may be prescribed in the instructions issued with respect to the return. Such return shall be filed annually regardless of whether such organization is chartered by, or affiliated or associated with, any central, parent, or other organization. Tax Regulation §1.6033-2(a)(2)(i) states in pertinent part that every organization exempt from taxation under section 501(a), and required to file a return under section 6033 and this section (including, for taxable years ending before December 31, 1972, private foundations, as defined in section 509(a)), other than an organization described in section 401(a) or 501(d), shall file its annual return on Form 990.

Tax Regulation §1.6033-2(i)(1) states that an organization which is exempt from taxation under section 501(a) and is not required to file annually an information return required by this section shall immediately notify in writing the district director for the internal revenue district in which its principal office is located of any changes in its character, operations, or purpose for which it was originally created.

Section 1.6033-2(i)(2) states that every organization which is exempt from tax, whether or not it is required to file an annual information return, shall submit such additional information as may be required by the Internal Revenue Service for the purpose of inquiring into its exempt status and administering the provisions of subchapter F (section 501 and following), chapter 1 of subtitle A of the Code, section 6033, and chapter 42 of subtitle D of the Code. See section 6001 and §1.6001-1 with respect to the authority of the district directors or directors of service centers to require such additional information and with respect to the books of accounts or records to be kept by such organizations.

Rev. Rul. 68-46, 1968-1 C.B. 260, describes another veterans' post. After an analysis of all the facts and circumstances, the Service determined that the post's primary activity was the conduct of a business rather than social welfare activity. The organization's

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business activities involved the rental of its commercial office building and operating a public banquet and meeting hall with a bar and dining facilities. Although the organization carried on veterans' programs and other social welfare activities, based on an analysis of the whole operation, it was concluded that the business activities relating to the operation of the facility exceeded all other activities, and the social welfare programs were not its primary activity.

Rev. Rul. 61-158, 1961-2 C.B. 115, describes an organization that was created exclusively for the promotion of social welfare, but whose principal activity was conducting a lottery on a weekly basis with the general public. Its principal source of income was the gross receipts from the weekly lottery. The major portion of the profits of the lottery was used for the payment of general expenses of the organization and only a small portion was used for social welfare purposes. The ruling holds that the organization is not operated exclusively for the promotion of social welfare because its primary activity is the conduct of a business for profit. Accordingly, it is not exempt under section 501(c)(4) of the Code.

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 provision 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 its exempt status.

In National Association of Postal Supervisors v. United States, supra, the Federal Circuit affirmed the Claims Court and held that dues collected by a tax-exempt labor organization from "limited-benefit members" were unrelated business income. Limited benefit members could not vote or hold office, although an amendment to the organization's constitution allowed them to serve on committees in an advisory capacity.

In American Postal Workers Union, AFL-CIO v. United States, supra, the Service held that dues from "associate members" (i.e., non-postal members) were unrelated business income where such members were entitled to insurance benefits, but were not members in any other sense.

In National Association of Life Underwriters, Inc. v. Commissioner, supra, the court looked at the above cases for guidance in determining whether individuals were members of an association within the meaning of section 1.512(a)-1(f) of the regulations regarding the treatment of advertising income as unrelated business

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income. The court, in concluding that certain individuals were not members, found that the purported "members" had no right to participate in the organization's direction, had no obligation to help support the organization through regular financial contributions, and did not constitute members in the organization's articles of incorporation and by-laws.

Law 4 & 5:

Section 11 of the Code imposes a tax for each taxable year on the taxable income of every corporation.

Section 61 of the Code defines gross income as all income from whatever source derived.

Section 162 of the Code allows as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 1.6001-1(d) of the Regulations requires corporations to make such returns, render such statements, or keep such specific records as will enable the Service to determine whether or not such corporation is liable for tax under subtitle A of the Code.

Section 1.6012-2 of the Regulations requires every corporation subject to taxation under subtitle A of the Code to make a return of income regardless of whether it has taxable income or regardless of the amount of its gross income. In addition, this regulation specifies Form 1120 as the required return of a corporation.

Taxpayer's Position 1:

The ORG's position is not known at this time as this is a draft report.

Government's Position 1:

An organization must satisfy two requirements to be described in Section 501(c)(19) of the Code. First, the organization must satisfy a membership test, and second, its activities must further the purposes listed in Section 1.501(c)(19)-1(c) of the regulations. If the membership requirements are not satisfied, then the organization will not qualify for exemption under section 501(c)(19).

The membership test under section 501(c)(19) of the Code provides that an organization's membership must be composed of the following:

- 75% of the membership must consist of past or present members of the Armed Forces;

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- Substantially all of its other members need to be individuals who are cadets or are spouses, widows, or widowers of past or present members of the United States Armed Forces or cadets. "Substantially all" has been defined to mean 90% of the remaining 25% of the membership. Therefore, 22.5% of the organization's membership can consist of cadets, spouses, widows and widowers of cadets or members of the Armed Forces; and
- The remaining 2.5% of the membership can be anyone.

In the instant case, ORG's membership requirements are governed by the bylaws provided by the HQ. For the years under examination, ORG's membership consisted of four classes of membership:

- ❖ Full Members - Persons who have served in the armed forces, widow or widowers, and spouses of persons who have served in the armed forces.
- ❖ Auxiliary Members – Any person related by second degree to an individual who served in the armed forces and received an honorable discharge.
- ❖ Honorary Members – Members who serve ORG, may or may not be a veteran, and are given a life time membership.
- ❖ Associate Member – Men or Women who have never served in the military, nor married to a person who has served in the military.

Section 501(c)(19) of the Code does not define the meaning of member as being an individual who has the right to control the day-to-day operations of the organization, such as having the right to vote. Membership in a section 501(c)(19) organization is based upon analyzing the organization's organizing document, which defines the rights and obligations of membership.

In determining whether an individual is a member of a veterans' organization for purposes of section 501(c)(19) of the Code, such an individual must be involved in the organization in such a manner as to further the organization's exempt purposes, rather than joining to receive a personal benefit, such as the right to receive free food while being a patron at the bar.

ORG provided a membership list of 13 people and provided DD-214s for each person. Even though the organization has presented a list of 13 names that happen to be Veterans, it does not mean that they are Bona Fide members.

Based on the facts of the case, it appears that ORG's Membership are not bona fide members and should not be part of the membership calculation for purposes of section 501(c)(19) of the Code. Members have no voice in the operations of the organization. The organization is run like a sole proprietorship bar and members do not have a say in its operations. Therefore, since the organization does not have bona fide members, it fails the membership test under 501(c)(19) because it has no membership. See

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National Association of Life Underwriters, Inc. v. Commissioner, supra and Section 501(c)(19) of the Code.

Taxpayer's Position 2:

The ORG's position is not known at this time as this is a draft report.

Government's Position 2:

An organization described in section 501(c)(19) of the Code carries out activities in furtherance of its exempt purposes only when such activities are carried out exclusively in furtherance of the purposes listed in section 1.501(c)(19)-1(c) of the regulations. Among these purposes is the provision of social and recreational activities for its members. Therefore, when a veterans organization described in section 501(c)(19) provides social and recreational activities for its members, or for guests whose expenses are paid by members, it is engaged in activities in furtherance of its exempt purposes.

Where goods or services are furnished to nonmembers who provide payment for such goods or services, their furnishing is outside the scope of section 1.501(c)(19)-1(c) of the regulations. Generally, if an organization has not kept adequate books and records concerning its financial transactions with nonmembers and more than 50 percent of its gross receipts are derived from sales transactions (e.g. bar sales), the presumption will be that the organization's exempt status should be revoked because it is not primarily engaged in section 501(c)(19) activities. However, this presumption may be rebutted. All facts and circumstances must be reviewed to determine whether or not the organization primarily engaged in section 501(c)(19) activities.

Although relatively little documentation has been provided with respect to the organization's exempt activities during the year in question, it is believed the organization conducted some exempt activities under section 501(c)(19), including membership meetings and a few charitable activities. However, even considering the information provided, it appears that member activity was relatively minimal when compared with the organization's bar and social activities available to the public.

During the year under examination, there was no permanent mechanism in place to maintain records to distinguish between income from "veteran" members, members' families, bona fide guests, auxiliary members, and non-veterans income, with respect to the organization's bar and social activities.

While the operation of a bar may further an exempt purpose under section 501(c)(19), such activities are not engaged in for the members' social and recreational benefit when the facility is open to the public. Based on the interview with the President of the

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ORG, it was determined that over 50% of the usage of the bar and restaurant was by members of the general public. No accurate records were maintained indicating use by members and nonmembers. As noted above, during the interview it was stated that the organization normally serves 30 per day. Since there are only 13 members, the organization is serving primarily to the general public. Based upon the available information, the operation of the bar is a public activity that primarily serves to non members and only incidentally a member activity.

The level of activity with the general public engaged in by the organization overshadows the organization's exempt activities, particularly in view of the absence of adequate books and records pertaining to the year in question, which is required by sections 6001 and 6033 of the Code, Sections 1.6001-1 and 1.6033-2 of the regulations, and Rev. Rul. 59-95, 1959-1 C.B. 627.

Although the organization undoubtedly carried on some programs in furtherance of exempt purposes under section 501(c)(19) of the Code, based upon an analysis of the whole operation and in view of the unavailability of adequate records, we believe that the business activities relating to the operation of the bar, all of which were available to the public, predominate over the inadequately documented exempt activities.

Based upon the information submitted, the organization has not met its burden of proof by furnishing sufficient records to show that it is not operating a business for profit by operating a bar open to the general public. Operation of an establishment open to the public neither accomplishes social welfare or any other section 501(c)(19) purposes. See Rev. Rul. 68-46 1968-1 C.B. 260, Rev. Rul. 61-158, 1961-2 C.B. 115, and Section 1.501(c)(19)-1(c) of the Regulations. These activities establish that the organization is not operated exclusively for exempt purposes under section 501(c)(19) of the Code.

Taxpayer's Position 3:

The ORG's position is not known at this time as this is a draft report.

Government's Position 3:

Section 511 of the Code provides that if income is designated unrelated trade or business income, it shall be taxed at rates as prescribed under Section 11 of the Code. Unrelated trade or business income as described in Section 512 is gross income derived from an unrelated trade or business that is regularly carried on. Section 513 defines an unrelated trade or business as an activity that is not substantially related to an organization's exempt purpose.

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Per the interview with the President of ORG, the organization serves primarily to the public. ORG did not keep the required records to delineate between member and non member income as required by Section 1.6001-(c) of the Regulations.

Since ORG has not complied with the record keeping requirement and the organization is open to the public, the burden of proof is on the ORG to prove that a portion of its income wasn't from an unrelated trade or business. Unless additional records are submitted to substantiate the amount of non member income, it is presumed that 100% of the organization's income is considered from an unrelated trade or business and is subject to corporate tax under Section 11 of the Code.

Rev. Rul. 68-46, 1968-1 C.B. 260, describes another veterans' post. After an analysis of all the facts and circumstances, the Service determined that the post's primary activity was the conduct of a business rather than social welfare activity. The organization's business activities involved the rental of its commercial organization carried on veterans programs and other social welfare activities, based on an analysis of the whole operation, it was concluded that the business activities relating to the operation of the facility exceeded all other activities, and the social welfare programs were not its primary activity.

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 return 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.

Section 6001 of the Code requires organizations exempt from tax to retain minimum records sufficient to detail their exempt function activities. ORG has failed to maintain sufficient records on gross receipts from member vs. non-member income.

Taxpayer's Position 4:

The ORG's position is not known at this time as this is a draft report.

Government's Position 4:

Section 11 of the Code imposes a tax for each taxable year on the taxable income of every corporation.

Section 61 of the Code defines gross income as all income from whatever source derived.

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The calculations of the tax due are as follows:

Conclusion

1. During the examination process, it was shown that ORG did not have a Bona Fide membership. Therefore, it does not meet the membership test and/or qualify for exemption under Section 501(c)(19) of the Code. Accordingly, the organization's exempt status is revoked effective January 1, 20XX. Form 1120 returns should be filed for the tax periods ending on or after December 31, 20XX.
2. During the examination process, the ORG did not provide adequate information to show the ORG devoted at least 50% of their time to activities in furtherance of the organization's exempt function. Based on the information provided, it appears that the organization primarily operates a bar open to the public. Since operating a bar open to the public does not further Section 501(c)(19) purposes, it does not qualify for exemption under Section 501(c)(19) of the Code. Accordingly, the ORG's exempt status is revoked effective January 1, 20XX. Form 1120 returns should be filed for the tax periods ending on or after December 31, 20XX.
3. Because the ORG did not keep proper records related to non member income and the organization is open to the general public, the burden of proof to prove that the organization had member income is on them. Therefore, unless additional records are provided to prove the organizations member income, 100% of the bar income will be considered non member income subject to tax.