

Internal Revenue Service
Appeals Office
312 Elm Street, Suite 2330
Cincinnati, OH 45202-2763

Department of the Treasury

Person to Contact:

Employee ID Number: *****

Tel: *****

Fax: *****

Refer Reply to:

In Re:

EO Revocation

Form Required to be Filed:

1120

EIN:

Tax Period(s) Ended:

UIL: 501.08-00

Date: APR 08 2011

Number: 201126040

Release Date: 7/1/2011

CERTIFIED MAIL

Dear :

This is our final adverse determination that you do not qualify for exemption from Federal income tax under Internal Revenue Code (IRC) section 501(a), as an organization described in section 501(c)(8).

Our adverse determination was made for the following reason(s):

You did not operate exclusively for the fraternal and beneficial purposes of an organization described in section 501(c)(8) of the Code.

You are required to file Federal income tax returns on the form indicated above. You should file these returns within 30 days from the date of this letter, unless a request for an extension of time is granted. File the returns in accordance with their instructions and send them to the appropriate IRS service center for the tax year ending December 31, 20 and any tax years thereafter. Failure to file the returns timely may result in a penalty.

Please show your employer identification number on all returns you file and in all correspondence with Internal Revenue Service.

You also 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 is not able to reverse legally correct tax determinations, nor extend the time fixed by law that you have to file a petition in the U.S. Tax 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. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. See the enclosed Notice 1214, *Helpful Contacts for Your "Notice of Deficiency"*, for Taxpayer Advocate telephone numbers and addresses.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

APPEALS TEAM MANAGER

CC: *****



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY

Internal Revenue Service
550 Main Street, Room 6417
Cincinnati, Ohio 45201

APR 16 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,

Nanette M. Downing
Acting 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
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

LEGEND

ORG = Organization name XX = Date Address = address City = city
State = state President = president Vice President = vice president
Secretary = secretary CO-1 through Co-10 = 1st through 10th COMPANIES
RA-1 THROUGH RA-17 = 1ST THROUGH 17TH RA

ISSUES:

1. Whether, under the circumstances described, ORG meets the requirements for continued recognition of exemption under section 501(c)(8) of the Internal Revenue Code.
2. Whether, ORG would qualify as an organization described in section 501(c)(10) of the Code.
3. Whether, ORG would qualify as an organization described in section 501(c)(7) of the Code.
4. Whether, ORG would qualify as an organization described in section 501(c)(4) of the Code.

FACTS:

Organizational Structure: ORG (ORG) is a corporation registered in the state of State since 19XX. ORG is recognized by the Internal Revenue Service as tax exempt under Section 501(c)(8) of the Internal Revenue Code (IRC), since November of 19XX.

Amended Articles of Incorporation were adopted on November 4, 20XX, which include the following changes:

Paragraph 6, Stated corporate purpose shall now read as follows: The purpose for which this corporation is formed is for charitable, religious, educational, fraternal, and scientific purposes or to encourage any other activities within the range of the purposes of this corporation as may be deemed advisable and within the limitations provided by its Articles of Incorporation or By Laws; including for such purposes, the making of distributions to organizations under Section 501(c) of the Internal Revenue code, or corresponding section of any future federal tax code.

Paragraph 7, The stated primary purpose shall now read as follows; The primary purpose for which this corporation is formed is the promotion of fellowship and learning among its members; to conduct a fraternal association which will act as a charitable organization; to use such means necessary to promote good fellowship and learning among its members; to purchase or lease a building for the use and comfort of the members of the corporation; to acquire real and personal property by purchase, gift, devise, or bequest; and to act as a parent or grand lodge to other related subordinate lodges; all of which purposes are to be carried out not for profit and without shares of stock; but only to promote the moral, social, and educational welfare of its members; and generally, to do the things that are incident and necessary thereto.

Paragraphs 8, 9, and 10 Corporate President, Corporate Vice-President/Treasurer Vice President, and Corporate Secretary Secretary, will not change, whose address will continue to be Address, City, State.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Period Ended
ORG		December 31, 20XX December 31, 20XX December 31, 20XX

Paragraph 11, Newly added Article: Notwithstanding any other provision of these articles, this corporation shall not carry on any other activities not permitted to be carried on by a corporation exempt from federal income tax under section 501(c)(8) of the Internal Revenue Code, or the corresponding section of any future federal tax code, or by a corporation, contributions to which are deductible under section 170(c) of the Internal Revenue Code, or corresponding section of any future federal tax code.

Paragraph 12, Newly added article: No part of the net earnings of this corporation shall inure to the benefit of, or be distributable, as defined in State Code Section 31E-1-150(8), to its members, trustees, officers, or other private persons, except that this corporation shall be authorized and empowered to pay reasonable compensation for services rendered and to make payments and distributions in furtherance of the purposes set forth in Article 6, hereof.

A subsequent amendment to the Articles of Incorporation was made on April 22, 20XX, and provides in part as follows:

Paragraphs 8, 9, and 10 of the Amended Articles of Incorporation dated November 4, 20XX shall be deleted.

Paragraph 7 shall be amended to read as follows: The primary purpose for which this corporation is formed is the promotion of fellowship and learning among its members; to conduct a fraternal association which will act as a charitable organization; to use such means necessary to promote good fellowship and learning among its members; to purchase or lease a building for the use and comfort of the members of the corporation; to acquire real and personal property by purchase, gift, devise, or bequest; and to act as a subordinate to the CO-1, Inc located in City, State; all of which purposes are to be carried out not for profit and without shares of stock; but only to promote the moral, social, and educational welfare of its members; and generally, to do the things that are incident and necessary thereto in accordance with section 501(c)(8) of the Internal Revenue Code, or the corresponding section of any future federal tax code.

Membership: Paragraph 17 of ORG's articles of incorporation adopted on November 4, 20XX, provide: The ORG, shall have members. Membership shall include any person who has attained the age of twenty-one (21) years and who is a legal citizen of the United States, who shares our beliefs in Patriotism, Loyalty and Freedom. Any person desiring membership shall obtain from the lodge a proper application form, complete the form, return form with proper fees. Applicants must have the sponsorship of one (1) member in good standing.

ORG provided copies of its 20XX, 20XX, 20XX, and 20XX membership rosters. A sampling of names from the 20XX, 20XX, and 20XX rosters were selected by the Service, for review of membership source documentation as shown in the table below.

<u>Membership Roster</u>	<u>Number of Members</u>	<u>Sample</u>	<u>Membership Applications</u>	<u>I.D. Cards</u>
20XX	100	20	0	16
20XX	113	5	0	4

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer		Year/Period Ended
ORG		December 31, 20XX December 31, 20XX December 31, 20XX

20XX	196	5	3	1
Total	409	30	3	21

The applications and identification cards provide only the name, address, date of birth, and date of completion. Applications include the statement, "I hereby apply for membership in your ORG, and if granted promise to observe all governing laws of the ORG. The identification cards also include the telephone number, (if provided), of the member.

A comparison was made between the 20XX, 20XX, 20XX, and 20XX rosters. Only 7 of the 100 members listed on the 20XX roster were found on all of the other rosters. There were 12 members in common between the 20XX and 20XX rosters, 39 members in common between the 20XX and 20XX roster, and 182 members in common between 20XX and 20XX.

ORG provided copies of Forms W-2G,(Certain Gambling Winnings) it issued in 20XX and 20XX. The Service obtained transcripts of W-2G's issued for 20XX. W-2G's filed by ORG show three W-2G's were issued in 20XX to persons not found on the 20XX membership roster, two W-2G's were issued in 20XX to persons not found on the 20XX membership roster, and six W-2G's were issued in 20XX to persons not found on the 20XX roster. See the table below.

Year	Name	Amount	Year	Name	Amount
20XX	RA-1	\$\$	20XX	RA-7	\$\$
20XX	RA-2	\$\$	20XX	RA-8	\$\$
20XX	RA-3	\$\$	20XX	RA-9	\$\$
20XX	RA-4	\$\$	20XX	RA-10	\$\$
20XX	RA-5	\$\$	20XX	RA-11	\$\$
20XX	RA-6	\$\$			

A tour of the CO-4 was conducted by the Agent for Internal Revenue Service on July 11, 20XX. It was observed a billboard located just outside of the facility read "ORG, Don't Go By Give Our Place A Try, open 7 days a week 7 am - 3 am".

Activities: ORG operates a club located at Address, City State. The facility was leased by ORG for the years 20XX, 20XX, and 20XX. ORG also operated an annex at Address, City State, for a period of time in 20XX and 20XX. The CO-2 was leased from CO-3.

Both facilitates were licensed in the state of State to conduct gaming. The CO-4 operates ten video poker machines, while the CO-2 operated five video poker machines. (See exhibit # 1), for monthly gaming revenues.

ORG, ("Retailer") entered into a contract with CO-5, ("Operator") on March 13th, 20XX. The contract provides in part;

Whereas the parties desire to take advantage of the business opportunities presented by State Code Chapter 29, Article 22 B, commonly known as a Limited Video Lottery Act;

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

Whereas Operator is an Operator as that term is defined by the State Limited Video Lottery Act, (the "Act") and Retailer is or plans to become a "Limited Video Lottery Retailer" as that term is defined in the Act:

Whereas Retailer, after mature consideration, wishes to obtain the assistance and guidance of Operator in the establishment of a location or locations to conduct business as a Retailer under the Act. Operator shall assist Retailer in establishing a place of business at Address, City, State, and at such other locations as Operator shall in its sole discretion deem advantageous. Operator shall assist the Retailer in obtaining any and all permits which may be required from any governmental agency in order that the Retailer may conduct business as an Alcohol Beverage Control Commission private club licensee and as a lottery Retailer licensee. Operator shall cause a builder to construct a facility adequately equipped to obtain such licensure and acquire such licenses required for Retailer to conduct business as a private club with a state of State Alcohol Beverage Control Commission license and a lottery Retailer license at the above address, and at such other locations as Operator shall in its sole discretion deem advantageous. Prior to the expenditure of any sums of money: Operator shall provide to Retailer a detailed summary of the anticipated cost both in labor and material for the work to be performed and shall advance the total cost of such construction and necessary licenses and permits in order for the Retailer to operate a private club at the location.

3. Operator shall provide financial assistance to assist Retailer with reasonable startup costs and reasonable necessary expenses incident to the operation of Retailer at the above location and at such other locations as Operator shall in its sole discretion deem advantageous for three months from Retailer's commencement of business at the above location and at such other locations as Operator shall in its sole discretion deem advantageous.

4. Any sums expended by the Operator pursuant to the obligations imposed upon it by this contract or made by the Operator with the consent or acquiescence of the Retailer or any of the Guarantors are hereby deemed to be loans from the Operator to the Retailer.

5. Retailer shall be under the following obligations and conform its conduct to the following Requirements: Retailer's share of the video lottery terminals proceeds shall be applied to the monthly expenses required for the operation of the Retailer's business at each location.

Retailer's share of the video lottery terminal proceeds in excess of the monthly expenses required for the operation of the location shall be for the account of the Retailer; provided however, until such time as the Retailer's obligations to the Operator under this agreement are fully paid and discharged, percent(%), of such proceeds, regardless of which of the Retailer's locations generate such proceeds, shall be paid to the operator and applied to the indebtedness owed to the Operator pursuant to this Agreement.

7. Any tangible personal property purchased by the Operator shall be the property of the Operator until such time as Retailer is no longer indebted to operator.

Form 990, Return of Organization Exempt From Income Tax: Contributions, video gaming revenue, net earnings, and grants & allocations were reported on Form 990, Return of Organization Exempt From Income Tax, as follows:

<u>Tax Period</u>	<u>Contributions</u>	<u>Video Gaming</u>	<u>Net Earnings</u>	<u>Grants and Allocations</u>
12/31/20XX	\$\$	\$\$	\$\$	
12/31/20XX		\$\$	\$\$	\$\$

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Period Ended
ORG		December 31, 20XX December 31, 20XX December 31, 20XX

12/31/20XX

\$\$

\$0

\$0

Part V, List of Officers, Directors, Trustees, and Key Employees, for periods ending December 31, 20XX and December 31, 20XX, shows President as President, Secretary as Vice President and Vice President as Secretary.

Part V, List of Officers, Directors, Trustees, and Key Employees, filed for the period ending December 31, 20XX, shows President as President, Vice President as Vice President and Secretary as Secretary.

Lease Payments: A commercial lease agreement was entered into between ORG and RA-12 on March 25, 20XX to lease 572 square feet of a building located at Address, City, State, for rental payments of \$\$ a month plus a \$\$ utility fee. The books and records of ORG show monthly lease payments of \$\$ were made to RA-1 from April 30, 20XX thru August 10, 20XX. Subsequent to that monthly lease payments, of \$\$ were made to RA-13, for the CO-5, beginning on August 25, 20XX thru December 24, 20XX. Two lease payments were made to CO-6 in June and August of 20XX. ORG did not provide a copy of the lease agreement with RA-13 or CO-6.

ORG made lease payments to CO-3 beginning in August of 20XX thru October of 20XX, for the City and CO-2s, totaling \$\$, (see exhibit # 2). However, no lease agreements between the two parties were provided. State Secretary of State records show President and Secretary are the incorporators of CO-3.

ISSUE 1 & 2 - LAW

Section 501(c)(8) of the Code provides, in part, for the exemption of fraternal beneficiary societies, orders, or associations 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.

Section 501(c)(10) of the Code provides for the exemption of domestic fraternal societies, orders, or associations operating under the lodge system, whose net earnings 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.

The leading judicial pronouncement as to what constitutes a "fraternal beneficiary society" is contained in the following extract from National Union v. Marlow, 374 F. 775, 778 (1896):

"... a fraternal-beneficial society ... would be 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....

Many of these associations make a practice of assisting their sick and disabled members and of extending substantial aid to the families

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Period Ended
ORG		December 31, 20XX December 31, 20XX December 31, 20XX

of deceased members. Their work is at the same time of a beneficial and fraternal character, because they aim to improve the condition of a class of persons who are engaged in a common pursuit and to unite them by a stronger bond of sympathy and interest....”

The National Union did not fit this definition, because it was an association of individuals who were associated for the purpose of obtaining insurance. The court concluded that:

In its practical operations, therefore, the defendant company cultivates fraternity and confers benefits in the same manner that every insurance company doing business on the mutual plan cultivates feelings of fraternity, and confers benefits upon its members. Or, in other words, when the defendant is stripped of all disguises, and judged by the standard of what it is engaged in doing, and what it was most likely organized to do, it is simply an insurance company which carries on an extensive business on the assessment plan.

Central to the concept of fraternal beneficiary societies, whether described in section 501(c)(8) or 501(c)(10) of the Code is the requirement of a fraternal element, a common bond among members. The requirement of a fraternal element is set forth in Philadelphia and Reading Relief Association, 4 B.T.A. 713 (1926).

In that case, an organization composed of railroad employees organized to administer a relief fund for the payment of benefits to its members in case of sickness, accident or death, fell short of this requirement because it lacked the required fraternalistic element. The court noted that the association’s membership consisted of individuals whose vocations were as numerous and diverse as the classifications of jobs of a railroad company; that the only motive for the existence of the association was a mercenary one (to provide insurance benefits); that the organization did not have “rituals, ceremonial, and regalia” commonly associated with fraternal associations; and that it was not operated on the lodge system.

In another case, the U.S. Tax Court held that an organization cannot be classified as fraternal when the only common bond between the majority of its members is their membership in that organization. Polish Army Veterans Post 147, 24 T.C. 891 (1955), affirmed as to nonexempt status, 236 F.2d 509 (1956). Only 10 percent of the members had common ties in that they were Polish war veterans or children of such veterans who had served in the armed forces of the Western Alliance. All other dues-paying members were admitted indiscriminately as long as they were elected to membership by a majority vote of members present at any meeting.

The question as to the meaning of “fraternal” was also explored in Wheeler v. Ben Hur Life Ass'n, 264 S.W.2d 289 (1953). The court concluded that the organization was not fraternal.

... The association's constitution and by-laws duly provide for a lodge system, ritualistic form of work, and representative form of government. It has no capital stock and is ostensibly organized solely for the mutual benefit of its members. But actually, while giving superficial attention to these requirements, the Association has been engaged in the life insurance business. The local agent of the Association draws a salary and receives as a commission 50% of the first premium on all insurance policies. He receives a smaller percentage of subsequent premiums . . . The Association's constitution

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

and by-laws provisions relative to ritualistic work are observed only perfunctorily . . . We are convinced from the evidence in this record that the primary function of the Ben Hur Life Association is to sell insurance, and that the Association actually is an insurance company operating under the guise of a fraternal benefit society.

Rev. Rul. 73-165, 1973-1 C.B. 224 concerns an organization that was operated under the lodge system, was engaged in conducting fraternal activities, but whose predominant activity was the provision of benefits to its members. The ruling concludes that the organization was described in section 501(c)(8) because there is no requirement that either the fraternal or the insurance features predominate so long as both are present. The ruling is clear, however, that in order for an organization to be described in section 501(c)(8) it must contain substantial fraternal features and conduct substantial fraternal activities. The courts have described fraternal activities as a grouping together of like-minded individuals to accomplish a common purpose. The group must be bound by more than membership in the organization and motivated by purposes other than solely the provision of insurance benefits.

Rev. Rul. 77-258, 1977-2 C.B. 195, provides that a domestic fraternal society operating under the lodge system, which does not provide life, sick, accident, or other benefits, whose members are interested in the use of and philosophy behind a method of attempting to divine the future, and whose net income is used to provide instruction on the use of the method, maintain a reference library, and supply information on the method to the public, qualifies for exemption under section 501(c)(10) of the Code.

ISSUE 1 & 2 - TAXPAYER'S POSITION:

Fraternal Purpose: – You stated in writing, the members are connected through their common value system as they support the objectives outlined in Article II of the Bylaws and as set forth below.

- To promote the social and moral welfare of its members;
- To encourage human and spiritual values of life;
- To provide through the ORG, a practical means to form meaningful friendships, altruistic services, and to build better communities;
- To promote true patriotism to our country and to be a loyal owl;
- To cooperate in creating and maintaining sound public opinion and high standards which make possible the promotion of goodwill and community concern for others; and
- To promote education for its members, their families, and the community.

Membership – You stated access to the lodge is restricted to members only. The door is locked at all times. Members ring a buzzer to gain admittance. The person monitoring the door verifies that the person seeking admittance is a member prior to unlocking the door and allowing admittance into the lodge. No guests were permitted access to the lodge.

Activities – You conducted monthly meetings. You provided a written explanation of fraternal activities or rituals conducted by the organization as follows. The name and emblem of our organization is that solitary and mysterious bird of the night, the Owl. From its appearance and habits we draw lessons, which can be practiced to yield benefits to others and ourselves. In the native haunts, the Owl is noted as being ever the enemy of the vermin and rodents that prey on the fruits of the soil. In emulation of the Owl, we encourage conduct that is foe of those evils which may prey on the character and fortunes of our

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Period Ended
ORG		December 31, 20XX December 31, 20XX December 31, 20XX

members and our community. As the appearance of the Owl suggests strength, wisdom, and wakefulness, we encourage cultivating wisdom and strength to protect the rights and liberties of ourselves and others and to be aware of opportunities for doing good works. As the plumage of the Owl is soft, we would have your manner to other Owls gentle, courteous and friendly; as its flight is swift and noiseless, we attempt to go quietly to the aid of an Owl when one needs assistance; as the Owl's sense of hearing is acute, we try to have open ears for the cry of a distressed Owl.

We have no tests whereby you can recognize a fellow member, except a card signed by the Secretary of one's Nest, showing good standing. The greeting sign is "Hoo-Hoo". This greeting sign is not to be considered secret, but may be used in public, at pleasure, whenever you wish to greet or attract the attention of an Owl. There is also a secret grip which members exchange to greet each other.

You further stated in writing, to better organize activities and to promote the common values of the members and to enhance fellowship among the members, the Owls established an Activities Committee during 20XX. This committee has worked hard at increasing member participation and to encourage kindness and concern for the sick and needy; education, sportsmanship and physical fitness of the youth and overall making the community a better place for all by participating in the following: Youth football, CO-7, Youth baseball, CO-8 - Members sponsored a dinner/dance to help cancer patients, Christmas stocking fund raiser for the needy family, Youth wrestling, Bake sale to support family who lost their 11 year old son, supported, "People to People Student Ambassador Program", to promote knowledge about international leadership among America's youth, Bake sale for eight year old boy in a motorcycle accident, Alzheimer's Walk, Halloween bake sale to help needy family, Christmas bake sale to help needy family, Bake sale to support kidney transplant patient, Spaghetti and chili dinners which are held on a weekly basis, birthday party, Bake sale to benefit the Veteran's Clinic, and established a pool league that meets weekly.

The Owls believe that in order to truly make a difference in the community it is important to set an example for the youth so that the values of the youth become second nature before they reach adulthood. Many of the members participate in volunteer activities to support youth sports and other activities. For at least the last four years, the Owls have donated between approximately \$\$ to \$\$ annually to charitable causes. The Owls renovated the facility to create a larger more accommodating floor plan by eliminating some storage area. It now has a full kitchen, serving area, and a maximum seating capacity of \$ people.

In a written response to a request for additional documentation of your activities, to include the dates of each event, names of members participating, and gross receipts and direct costs, for 20XX, 20XX, and 20XX, you stated the organization was starting to become more active during this time period so the organization of activities and recordkeeping was not well developed. During these years, members held a covered dish dinner every other Friday night. Additionally, in July of 20XX, the Owls organized and sponsored the "Youth Alcohol Drug Awareness" or "YADA" event held at Field in City. It was an all day football clinic for local youth. A former NFL player, RA-14, was used to bring the kids in for football and then warned them of the dangers of drugs/alcohol. Charitable contributions were made out of the general fund. Additionally, the organization made a donation of \$\$ to the Volunteer Fire Department as well as a donation of \$\$ to the local domestic violence shelter. At least three different donations in the amount of \$\$ each were made to Kids First in City. No other records were kept of

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

member participation in these activities. During this time period, members were in good standing if all dues were paid.

Benefits to members – In a written response to a request to explain your benefits to members, you stated, members in good standing at the time of death are entitled to a \$\$ death benefit. These benefits are paid to either the named beneficiary on the members' application or the next of kin or the members' estate. Death benefits are payable to a beneficiary or the members personal representative upon providing proof of the members' death (i.e. obituary or death certificate). Members do not make contributions to the death benefit fund. You later stated, death benefits are paid out of the general fund.

Lease Payments to CO-3: In a written response, to provide an explanation for the purpose of payments to CO-3 and provide documentation to support the fair rental value, you stated, the \$\$ paid to CO-3 was for rent at the CO-2 and CO-5s and for tenant alteration. The City lease was an annual rental amount of \$\$ for the building for 572 square feet with and additional \$\$ paid by the tenant for utilities with the exception of telephone services.

The CO-2 lease arrangement was an annual rental amount of \$,\$ for the building for 700 square feet and \$,\$ for the lot. The Owls paid all utilities for this location.

The Owls believe the rentals were very reasonable and include correspondence from RA-15 at CO-9, Inc. regarding the City and CO-2s, on CO-9 Inc. letterhead, stated;

- "Based on my professional opinion, the annual rent for the above property, (Address, City, State), should fall into the range of \$ - \$ per sq. ft., due to location and condition of property." Signed and dated 3/18/20XX.
- On Address, City, State, "Based on the location of this property, size of lot and building, with proximity to CO-10, RA-16, and the bridge to State, the annual rent should be \$.00 per square foot." Signed and dated 3/23/20XX.
- A second statement was provided from RA-17. "I have been involved in the commercial real estate business for over twenty years. I have sold, bought, leased and leased out real estate all over the mid State valley. I also hold my real estate broker license in the state of State. Based on my knowledge and experience the real estate and business located at Address, City, State would have approx. a commercial rental value of \$,\$ per month based on the way the business was in the years 20XX-20XX.
The property and business at Address, City, State would have had a commercial rental value of conservatively \$ per month for the years 20XX-20XX.
The above estimates are based on market value of like businesses, location and square footage of the buildings and lots in use."

Further, you stated you were not reimbursed for improvements you made to the City and CO-2s.

ISSUE 1 & 2 - GOVERNMENT'S POSITION:

The information you provided fails to establish that you are a fraternal society, order, or association that qualifies for exemption from federal income tax under section 501(c)(8) or 501(c)(10) of the Code. You

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

do not have an established system for payment of benefits to members; you are not operated for fraternal purposes; and you do not devote your net earnings to exclusively charitable or fraternal purposes.

Fraternal Purposes: Although there is no definition of fraternal purpose in the Internal Revenue Code, we presume that Congress used the term in the ordinary sense, and according to its legal significance in 1909 when section 501(c)(8) was added. The courts in the cases cited above, were clear in requiring at a minimum that the members of a fraternal organization have a common tie that is more substantial than the desire to purchase insurance or engage in social activities. "An organization cannot be classed as fraternal where the only common bond between the majority of the members is their membership in that organization." Polish Army Veterans Post 147. Evidence of fraternal activities, such as "rituals, ceremonial, and regalia," helps to establish that an organization has a fraternal purpose. Philadelphia and Reading Relief Association, supra.

Rev. Rul. 73-165 echoes Congress and the courts in holding that to establish exemption, a fraternal organization must have substantial fraternal features and conduct substantial fraternal activities. Lastly, we look to substance over form. The fact that an organization's constitution and bylaws may provide for a "lodge system, a ritualistic form of work, and representative form of government" is not enough if actual operations establish a primary function that is not fraternal. Wheeler v. Ben Hur Life Association, supra.

You do not have substantial fraternal features. Your membership is open to anyone over 21, and who is a legal citizen of the United States, who shares beliefs in Patriotism, Loyalty and Freedom. Your bylaws do not require and you submitted no evidence to establish that your members have a specific "calling, avocation or profession" or a "common tie." Unlike the organization described in Rev. Rul. 77-258, whose members had a single pursuit, your activities do not illustrate how your members have joined together or worked in unison to accomplish any worthy objective. The only common bond among your members appears to be their membership.

Membership: A comparison of your membership rosters shows substantial turnover in your membership thru 20XX, 20XX, and 20XX. Further, you stated that nonmembers and guests are not permitted access to the lodge. However, W-2G's issued by you in 20XX, 20XX, and 20XX were issued to persons other than those shown on your respective annual membership rosters. A billboard also advertises to the public to patronize your facility. No membership applications were available for the sample of members from the 20XX and 20XX rosters. Membership applications provided for some of the 20XX members contain minimal information which includes, the name, address, date of birth, and the date the application was signed. The applications do not identify the sponsoring member as required by paragraph 17 of the articles of incorporation. Nor, do they show the designated beneficiary for benefits. Without further documentation, we are unable to conclude that you are not open to the general public in the same manner as a commercial club.

Activities: Your meeting minutes do not reflect any rituals. You also stated in a 20XX survey response to your "Home Nest", you do not conduct any rituals specific to the ORG of Owls, (ex: new member initiation, meeting protocols, and rituals, regalia, etc.). You have not submitted evidence that your listed members have actually participated in substantial fraternal activities. Your operation of a private club and conduct of gaming is not inherently a fraternal or a charitable activity. Your charter and bylaws do

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

not provide for rituals, ceremonials or regalia commonly associated with fraternal associations. Nor have you engaged in any member activities in furtherance of your stated objectives. Accordingly, you are not operated for fraternal purposes.

Devotion of Net Earnings to Exclusively Charitable or Fraternal Purposes: The information you submitted shows that gaming is your primary activity. Net terminal income from the video lottery machines is allocated 40 percent to you and 60 percent to A-1 Amusements Inc. Contributions you received in 20XX were used in the establishment and operation of your club and not used exclusively for charitable purposes. Operation of the club is your primary activity and that substantially all of your earnings have been used for this purpose. You did not provide lease agreements with CO-3. Your books and records reveal you were making lease payments to other entities for the CO-5 while simultaneously making payments to CO-3. You also made significant improvements to the CO-2 and were not reimbursed by CO-3 after you ceased operations at that location. We are unable to conclude from the information submitted that your net earnings do not inure to President and Secretary in the form of inflated payments for services rendered through CO-3. Death benefit payments are made from your general fund which is a form of private benefit to your members. There is no indication, from the returns filed and from your books and records, members paid dues in 20XX, 20XX, and 20XX. However, dues were paid to the Home Nest, which apparently came from your general operating fund. This also is a form a private benefit to your members.

In addition, you stated that providing social and recreational activities for your members is a fraternal purpose. A fraternal organization may provide social and recreational activities to its members but this activity alone is insufficient to establish exemption. Where, as in your case, gaming is predominantly a public activity, it would be considered unrelated to the exempt purposes of a fraternal organization. Since we have determined that you are not operated for fraternal purposes, we conclude further that none of your net earnings are devoted to fraternal purposes.

ISSUE 1 & 2 – CONCLUSION:

Under the circumstances described ORG, we have determined that you do not meet the requirements for continued exemption under section 501(c)(8) of the Code because you do not have a fraternal purpose and there is no established system for the payment to your members, or their dependents, of life sick, accident, or other benefits.

Further, ORG is not described in section 501(c)(10) of the Code because, you are not operated for fraternal purposes and you do not devote your net earnings to exclusively charitable and fraternal purposes.

ISSUE 3 – LAW:

Section 501(c)(7) of the Code provides for the exemption from federal income tax of clubs organized and operated for pleasure, recreation and other nonprofitable purposes substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

Public Law 94-568, October 20, 1976, amended the Code with respect to the requirements for tax exemption under section 501(c)(7). Senate Report No. 94-1318, Second Session 1976-2 C.B. 597, provides that the decision in each case as to whether substantially all of the organization's activities are related to its exempt purposes is to continue to be based upon all of the facts and circumstances. It is intended that these organizations be permitted to receive up to 35% of gross receipts, including investment income from sources outside their membership, without losing their tax-exempt status. It is also intended that within this 35% amount not more than 15% of the gross receipts should be derived from the use of a club's facilities or services by the general public. Gross receipts are to be interpreted for this purpose as those receipts from normal and usual activities of the club, including investment income. However, where a club receives unusual amounts of income, such as from the sale of its clubhouse or similar facility, that income is not to be included in the formula. That is, such unusual income is not to be included in the gross receipts of the club for purposes of the permitted 35 or 15 percent allowances. It is not intended that these organizations should be permitted to receive, within the 15 or 35 percent allowances, income from the active conduct of businesses not traditionally carried on by these organizations.

Rev. Proc. 71-17, 1971-1 C.B. 683, describes circumstances under which nonmembers who use a club's facilities will be assumed to be guests of members. These circumstances provide that income from bona fide guests will be treated as member income if the payment is made directly by the member.

ISSUE 3 – TAXPAYER’S POSITION

ORG’s position is unknown with respect to exempt status under section 501(c)(7).

ISSUE 3 – GOVERNMENT’S POSITION

The difficulty with ORG being reclassified under section 501(c)(7) of the Code is that it would need to maintain records showing the use of the club and gambling, by category (member, bona fide guest, and nonmember use). See Rev. Proc. 71-17, *supra*, and section 6001 of the Code. "ORG" maintained no records showing nonmember or guest use that would be nonmember income rather than exempt function income under section 501(c)(7).

Furthermore, exemption under section 501(c)(7) of the Code limits the receipt of nonmember income from the use of a club's facilities by the general public to 15% of total gross receipts. Based on the information submitted, ORG has not shown that its gross nonmember income during the examination period is less than or equal to 15% of total gross receipts from the use of club facilities by the general public. Therefore, ORG could not be reclassified as an organization described in section 501(c)(7).

CONCLUSION:

State ORG Inc has failed to establish qualification for tax-exempt status under section 501(c)(7).

ISSUE 4 – LAW:

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer		Year/Period Ended
ORG		December 31, 20XX December 31, 20XX December 31, 20XX

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

Section 1.501(c)(4)-1(a)(2) of the Income Tax Regulations describes the promotion of social welfare as promoting in some way the common good and general welfare of the people of the community, such as bringing about civic betterments and social improvements. An organization is not operated for the promotion of social welfare if its primary activity is operating a social club for the benefit, pleasure, or recreation of its members, or is carrying on a business with the general public in a manner similar to organizations which are operated for profit.

Rev. Rul. 74-361, 1974-2 C.B. 159, holds that a volunteer fire company that charges a fee for admission to public dances it conducts each week may qualify for exemption under section 501(c)(4) of the Code because it is promoting the common good and general welfare of the community through its primary activity of providing fire and ambulance service to the community. As an adjunct to its fire fighting and rescue services, the fire company engages in other activities, such as recruiting volunteers and training them in first aid and rescue techniques, buying and maintaining fire fighting equipment, and raising funds for the company through mail and door-to-door solicitation of contributions.

In Rev. Rul. 68-455, 1968-2 C.B. 215, a war veterans' organization was held exempt under section 501(c)(4) of the Code even though it operated a resort concession. It was primarily engaged in the promotion of social welfare and expended the funds from its concession to acquire, maintain and operate buildings used in its active program of social welfare.

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 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. 68-45, 1968-1 C.B. 259, provides another example of the primary activity test imposed by section 501(c)(4) of the Code. It describes a war veterans' post whose principal source of income is from bingo games open to the general public, but whose principal activity is not bingo. Membership in the post is limited to war veterans. In concluding that the organization is primarily engaged in social welfare activities even if it receives a substantial portion of its funds from bingo, the Service emphasized the importance of determining the primary activity as opposed to the primary source of income. A determination of primary activity requires an analysis of all facts and circumstances. The Revenue Ruling states that an organization is not operated primarily for the promotion of social welfare if its primary activity is operating a social club for the benefit, pleasure, or recreation of its members, or is carrying on a business with the general public in a manner similar to organizations which are operated for profit.

Rev. Rul. 66-179, 1966-1 C.B. 139, provides that the extent to which an organization engages in social activities for the benefit of its members is a factor in determining whether it is primarily engaged in

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

social welfare activities. Even if a substantial part of an organization's activities consists of social functions for the benefit, pleasure and recreation of its members, it may qualify for exemption under section 501(c)(4) of the Code, if it is operated primarily to bring about civic and social improvements. The Rev. Rul. holds that a garden club that instructs the public on horticultural subjects, holds public flower shows, makes awards for horticultural achievements and also conducts substantial social activities qualifies as a social welfare organization under section 501(c)(4).

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.

ISSUE 4 – TAXPAYER’S POSITION

ORG’s position is unknown with respect to exempt status under section 501(c)(4).

ISSUE 4 – GOVERNMENT’S POSITION:

Section 501(c)(4) of the Code imposes an operational test on organizations described in that section. Social welfare organizations are not precluded from engaging in business activities per se, either as a means of providing direct community benefit or as a means of financing their social welfare programs. Thus, in Rev. Rul. 68-45, supra, the fact that the organizations engaged in some activities characterized as business with the general public (public dances, bingo) for the purpose of raising funds, rather than to provide direct community benefit, did not preclude a finding that they were nevertheless described in section 501(c)(4). An analysis showed that conducting veterans' activities (activities that directly benefit the community as a whole) was the organization's primary activity.

On the other hand, a business activity conducted as an organization's primary activity precludes exemption under section 501(c)(4) of the Code. Thus, in Rev. Ruls. 68-46 and 61-158, supra, exemption was precluded by a finding that the business activities of operating banquet facilities and conducting a public lottery were the organizations' primary activities. These activities, standing alone, provide no special benefit to the community independent from the monies raised. They differ little from the operation of commercial businesses other than the fact that the profits were earmarked for social welfare purposes.

The regulations state that the promotion of social welfare does not extend to the operation of a social club for the benefit of its members. Nor does it include carrying on business with the general public in a manner similar to organizations operated for profit. Therefore, in determining whether an organization is primarily engaged in social welfare activities, it is important to consider the extent to which it participates in business and social activities.

The use of proceeds derived from business or fundraising activities by a social welfare organization for

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

private purposes, such as providing special benefits for members, will cause denial of exemption. However, in characterizing the use of an organization's income, the promotion of social welfare may involve services to members as well as services to the community at large.

Based upon the information presented, ORG is operated primarily as a commercial concern and benefits not only members, but also the general public. Furthermore, ORG has not maintained the records required under section 6001 of the Code to determine whether it is operated for social welfare within the meaning of section 501(c)(4) of the Code.

CONCLUSION:

ORG has failed to establish qualification for tax-exempt status under section 501(c)(4)

Accordingly, it is determined that ORG is not an organization described in section 501(c)(8), or any other subsection under 501(c), and is not exempt from income tax under IRC § 501(c), effective January 1, 20XX. This organization is required to file Forms 1120 for all tax periods beginning after December 31, 20XX. In the cover letter issued to ORG, with a copy to each power of attorney, on March 26, 20XX, a closing conference was offered, but no request for a conference was made before the response due date of April 12, 20XX.