



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
Mandatory Review, MC 4920 DAL  
1100 Commerce Street  
Dallas, TX 75242

Release Number: **201323038**

Release Date: 6/7/2013

Date: February 20, 2013

501-04.00

LEGEND

ORG - Organization name

XX - Date Address - address

Date: 1/19/2011

Employer Identification Number:

ORG

Person to Contact/ID Number:

ADDRESS

Contact Numbers:

Voice:

Fax:

CERTIFIED MAIL - RETURN RECEIPT REQUESTED

Dear :

In a determination letter dated November 27, 20XX you were held to be exempt from Federal income tax under section 501(c)(4) of the Internal Revenue Code ("IRC"). In a subsequent determination letter, dated July 19, 20XX you received a favorable ruling as an organization having met the criterion for continued exemption under IRC § 501(c)(4) and a favorable ruling as a Central organization, recognizing your subordinate organizations are also exempt under IRC § 501(c)(4). The organization was assigned Group Exemption Number #####.

Based on recent information received, we have determined you have not operated in accordance with the provisions of section 501(c)(4) of the Code. Accordingly, your exemption from Federal income tax is revoked effective January 1, 20XX. This is a final adverse determination letter with regard to your status under section 501(c)(4) 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 November 10, 20XX, you signed Form 6018-A, *Consent to Proposed Action*, agreeing to the revocation of your exempt status under section 501(c)(4) of the Code.

Revenue Procedures 80-25 and 80-27 hold that when a Central organization no longer exists or qualifies for exemption under IRC 501(c), the group exemption letter is revoked. Accordingly, your determination letter dated July 19, 20XX is hereby revoked. The result of the revocation of the group exemption letter is the non-recognition of the exempt status of all your subordinate organizations. Each subordinate will be advised that it no longer qualifies for exemption. Each of your subordinate organizations must file an individual exemption application or a new group exemption application must be filed under the procedures of Revenue Procedure 80-27.

As a taxable entity, you are required to file Form[s] 1120, *U.S. Corporate Income Tax Return*, 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



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
Internal Revenue Service  
1122 Town & Country Commons Drive  
Suite 128, TE:GE:EO:7956  
Chesterfield, MO 63017

August 27, 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.

Letter 3610 (04-2002)  
Catalog Number 34801V

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,

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

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit:
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LEGEND

ORG - Organization name      ORG-1 - org-1      XX - Date      EIN - ein  
Address - address      City - city      State - state      President - president  
Vice President - vice president      Secretary - secretary      DIR-1 through  
DIR-4 - 1<sup>st</sup> through 4<sup>th</sup> DIR      EMP-1 - 1<sup>st</sup> EMP      RA-1 - 1<sup>st</sup> RA      CO-1  
through CO-21 = 1<sup>st</sup> through 21<sup>st</sup> COMPANIES

**ISSUES**

1. Whether, under the circumstances described, ORG meets the requirements for continued recognition of exemption under section 501(c)(4) of the Internal Revenue Code.
2. Whether ORG would qualify as an organization described in section 501(c)(7) of the Code.
3. Whether ORG would qualify as an organization described in section 501(c)(19) of the Code.

**FACTS**

**Background Information**

ORG is a social welfare organization whose purpose, according to its Articles of Incorporation dated June 1, 19XX, is to unite fraternally the wives of veterans with their husbands belonging to CO-1; to lessen the effects of the Vietnam veteran and their family and all other legal powers permitted General Not for Profit Corporations.

ORG, exempt under section 501(c)(4) of the Internal Revenue Code (the "Code") pursuant to a ruling dated November 27, 20XX, also holds a group exemption for subordinate organizations which, according to the group exemption determination letter dated July 19, 20XX, are also exempt from federal income tax under section 501(c)(4) of the Code.

CO-1 (CO-1) is a veterans organization, itself exempt under Section 501(c)(19) of the Code, that holds a group exemption for veterans organizations also described in I.R.C. § 501(c)(19). CO-1's web page states that its mission is to "unite veterans and their families by forming social clubs throughout the United States, which interact with other social veterans clubs."

CO-1's website lists several advantages to be included in its group exemption as a subordinate organization. These advantages include selling liquor, operating on Sundays, holding bingo games, and obtaining liquor licenses in dry counties. CO-1's website markets CO-1 and its group exemption to existing bars and restaurants located in State as a way to avoid restrictive local liquor laws and as a way to operate on a tax-

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exempt basis. CO-1's website states that CO-1 will assist in a club's formation and application for a liquor license. CO-1 refers to its subordinate organizations as "clubs."

CO-1's website requires that its clubs have at least 10 veteran members. CO-1 also requires its subordinate organizations to send it proof of all veterans' affiliation. One question that appears on CO-1's web page is "do I have to be a member's only club?" The response is "[a]lthough the tax advantages of being a members only club are greater, we do not require you to limit your bar to members.....Your doors may be kept open. By incorporating separately, you keep control of your own club. It is your choice if you wish to keep your doors open or closed. We only ask that you honor members of other chapters."

ORG was one such subordinate of CO-1. Accordingly, on February 9, 20XX, the ORG was contacted for the purpose of scheduling a joint interview with the officers and key staff of CO-1 and ORG (hereinafter collectively referenced as "taxpayers"). PRESIDENT and SECRETARY spoke on behalf of the taxpayers during the initial telephone contact. They provided that ORG continues on as an auxiliary of CO-1, however to accommodate CO-1's subordinates that did not meet the 501(c)(19) membership requirements, the taxpayers consulted the IRS to find out how to change ORG's exempt Code section to 501(c)(4), and was told it must change its EIN. Upon doing so, the newly exempt IRC 501(c)(4) organization itself became a parent organization effective, as previously indicated, July of 20XX.

The ORG is in the process of converting its subs to IRC 501(c)(7) pursuant to consultation with the IRS prior to being contacted for the purpose of the IRS examination. The taxpayers initiated this process in January 20XX. The taxpayers faxed a copy of the letter it submitted to the IRS with regard to the status change. **(Exhibit A)** Additionally, upon the advice of the IRS, the organization has notified its subordinates of the change. A copy of the letter to the subs was provided as well. **(Exhibit B)** The letter includes pages excerpted from Publication 3386, "Tax Guide-Veteran's Organizations", specifically the section on IRC § 501(c)(7) Social Clubs. The letter, addressed to "whom it may concern", advises that the excerpt from the publication explains CO-1s subordinates responsibilities and their affiliation to ORG. The taxpayer advises in the letter "ORG Headquarters group ruling is a 501(c)(4) with all the sub chapters classified under 501(c)(7). The letter goes on to advise members that a minimum of ten members are required and they need not be veterans, however must have common goals and interest through their social and recreational activities. The letter does not address increasing the membership beyond the initial ten member requirement.

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The property located at Address is CO-2 of which PRESIDENT is a partner. ORG and CO-1 rent their office and meeting space from PRESIDENT's LLC.

A joint interview was conducted with the Officers and key employees of CO-1 and ORG March 3 – 5, 20XX. A Memorandum of Interview was prepared with regard to information obtained during that interview. The inquiries and information obtained address the relationship between the two organizations, from the facility used to conduct their operations, to their staff and officers. The memorandum of interview is **Exhibit C**.

Documents provided by ORG, including internal and external communications, organizational documents, meeting minutes, and brochures provided a timeline to track the organization's transition from a subordinate of CO-1 to an independent organization exempt under IRC § 501(c)(4), and finally to a parent of IRC § 501(c)(4) subordinates, each of which ORG refers to as "Social Clubs".

Timeline per Documentation:

January 1, 19XX – Articles of Incorporation Filed for CO-1.

January 23, 19XX – Date of IRS Letter to CO-1 c/o DIR-1, RE: Group Exemption (GEN# \_\_\_\_\_), EIN. Letter confirms a ruling letter was issued to CO-1 in November 19XX granting the organization an exemption from Federal income tax under the provisions of Section 501(c)(19) of the Code of 1954.

June 21, 19XX – Date of IRS Letter 1313 to CO-1 c/o PRESIDENT, EIN: EIN, requesting additional information to show it met all legal requirements for recognition of Federal exempt status. The letter acknowledged the submission of Form 1024 (Application), however it was apparently devoid of a substantial amount of necessary information, as the list requesting documents and information is substantial. Page 2 of the letter advises "Since you are incorporated, a copy of the Amendment to your Articles of Incorporation reflecting the seal and signature of the appropriate State official must be submitted within the specified time."

August 9, 19XX – Certificate of Amendment of a State Nonprofit Corporation issued by the State Secretary of State amending the Articles of Incorporation to effect a name change, changing the name of the organization from CO-1 to ORG.

August 23, 19XX – Date of a document providing the names of the officers of the ORG (Address, City, State), as well as the number of employees (none), owner of the

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building (PRESIDENT), that PRESIDENT is an officer, that rent is \$, and that PRESIDENT is the contact person at #, the organization's EIN (EIN), Corp ID# N, State Tax Exempt (ID#), Date organization joined CO-1 (6/1/19XX), and Date of incorporation (June 1, 19XX). (Exhibit D)

December 7, 19XX – Date of IRS letter to CO-1, c/o PRESIDENT, EIN: EIN, acknowledging receipt of application for recognition of exemption from Federal income tax. Letter acknowledges organization recognized as exempt under IRC § 501(c)(19) in November 19XX, and the IRS therefore finds no need to consider the application. The letter confirms the organization is recognized as a subordinate unit of the parent organization, CO-1, and is covered under a group ruling # . (Exhibit E)

August 24, 20XX – 20XX Annual Registration Report of a Nonprofit filed with State Secretary of State's office. Officers named: PRESIDENT, President; Vice President, V-President; Secretary, Secretary. Board members are the same as Officers listed with no additional members listed.

May 17, 20XX – Date of IRS letter to ORG advising that Form 941 for tax period 03/20XX filed by the organization did not contain a valid EIN, and the IRS had no record of an EIN having been assigned to the organization. Since an EIN is required by law, the IRS assigned the organization EIN: . The letter advised the organization to return the bottom part of the notice if it already has an EIN, writing in the exact name and EIN shown on the notice it received assigning the EIN.

October 10, 20XX – Date of IRS Letter to ORG, c/o PRESIDENT, thanking the organization for applying for an EIN. The letter advises that EIN has been assigned to the organization. (Exhibit F)

November 27, 20XX – Date of IRS Letter 948 advising of favorable determination to recognize ORG, EIN: EIN, as exempt under § 501(c)(4), effective June 1, 19XX. The letter is addressed in care of PRESIDENT. (Exhibit G)

December 6, 20XX – Letter to IRS regarding present and future ORG subordinates. The letter advises of affiliation, control, exemption eligibility, purpose, sources of receipts, and nature of expenditures of subs. It also serves as transmittal for constitution of ORG, list of subs, Form 8718, and copy of parent's 501(c)(4) exemption letter. The letter was prepared for the signature of PRESIDENT, President. (Exhibit H)

December 6, 20XX – Letter to IRS regarding present CO-1 chapters wishing to transfer to ORG. The letter provides that all transferring chapters are affiliated with ORG

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Headquarters, subject to its general supervision or control, and are eligible to qualify for exemption under section 501(c)(4). The transferring chapters listed are:

- CO-1 - Address City, State (EIN: EIN)
- CO-3 - Address City, State (EIN: EIN)
- CO-Address, City, State (EIN: )

The letter was prepared for the signature of PRESIDENT, President. **(Exhibit I)**

March 27, 20XX – Letter to IRS. ORG prepared response to IRS' request for additional information for group ruling **(Exhibit J)**. The organization attached a policy statement from CO-3. The document is signed by DIR-2, and DIR-3.

April 11, 20XX – Date of IRS letter acknowledging organization's request for a group exemption letter. The letter asks for more information to complete consideration of the application:

- Advises that a policy statement was submitted for CO-3 but not for two others (CO-3 and CO-1)
- Advises two of the subs are 501(c)(19) organizations and exempt under another GEN (CO-3 and CO-4). The organization was asked to show how the structure and activities of the two have changed that they now qualify for 501(c)(4) status.
- The letter also asks for a detail description of the subs' activities and the percentage of time spent on each, how they will be funded, and a copy of their organizing document. **(Exhibit K)**

April 24, 20XX – Date of letter prepared in response to IRS' April 11 letter. **(Exhibit L)**  
 The letter advises that all subs . . .

- Are affiliated evidenced by a "Request for Inclusion"
- Are subject to ORG HQ's supervision and control
- Use the same constitution
- Are eligible for 501(c)(4) status
- Are individually incorporated

The letter further advises with regard to the sub that only Chapter 101 is to be included in the group ruling.

That while CO-1 101 is included in the CO-1 Chapter (501(c)(19) organization), its articles will be amended to change its name to CO-3, and change its purpose to the following:

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"To sponsor activities that promote patriotism, supporting active military and their families, to sponsor and participate in youth activities." The subs' purposes, activities, and funding:

- % meetings of support – gather together fraternally veterans and their families. Offer support by phone calls and socials for veterans and their families. Teaching proper flag etiquette, and dances.
- % organizational – paperwork such as 990 report, employee reports, annual Secretary of State reports, officers meeting. Officers meetings with members to explain what is required of their club, such as patriotic activities, (discussion on what activities can be done without funds such as clean up at local cemetery where veterans are buried, display flags, visiting the local VA hospital), supporting active military, (such as pen pal letters to active duty military, calling spouses to see if they need any help, etc., ), sponsor and participate in youth activities, (such as fundraisers for JROTC, sponsoring sports events: such as baseball, softball, etc., teaching the youth proper flag etiquette, distributing quizzes about Presidents and the flag: with the best score and essay receiving donated prize).
- % fundraising – take donations from the members and the public, Selling Army surplus supplies, having thrift store booth: selling donated items.

The letter is signed by PRESIDENT, Executive Director.

July 19, 20XX – Date of IRS Letter 2419 to ORG, c/o PRESIDENT, EIN: EIN, confirming its exemption under IRC § 501(c)(4) and issuing favorable group ruling determination recognizing the subs as 501(c)(4) organizations. The organization was assigned Group Exemption Number . (Exhibit M)

June 16, 20XX – Certificate of Amendment issued by State Secretary of State changing the name of organization from "ORG" to "ORG". The amendment application is signed by PRESIDENT, President.

April 3, 20XX - Certificate of Amendment issued by State Secretary of State changing the name of organization from "ORG" to "ORG-1". The amendment application is signed by PRESIDENT, CEO.

August 17, 20XX – Certificate of Amendment issued by State Secretary of State changing the name of the organization from "ORG-1" back to "ORG". The amendment application is signed by PRESIDENT, CEO.

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ORG provided two copies of its operating manual "BOOK". One was updated June 23, 20XX and the other January 3, 20XX. The organization provides a copy of this book to each of the "social clubs" that become member subordinates.

The June 23, 20XX revision of the Master Book opens with a letter dated May 19, 20XX advising "ORG-1 are a 501(c)(4) social organization, because their primary activities promote the social welfare of the community. There are no IRS membership requirements under the 501(c)(4), however ORG Headquarters does require you have at least 10 members. Your members do not have to be veterans just citizens who want to make 'BETTER COMMUNITIES THROUGH PATRIOTISM'.

To become a member of ORG you must:

- Request Chapter status, form enclosed.
- Incorporate your won chapter, this keeps your club separate from all other clubs and keeps your club totally under your control. (Articles of Incorporation included).
- Obtain an EIN (EIN application included.)

Fill out and sign Request for Chapter Status application.

Fill out Articles of Incorporation, along with a \$ check made out to the Secretary of State.

Sign EIN application and return all to ORG Hq.

Include a check or money order made out to ORG for \$ for chapter membership and \$ for each member."

The letter contains a signature line for Secretary, Administrative Executive.

The May 19, 20XX letter was removed from January 3, 20XX revision of the Master Book. This revision contains a letter dated January 2, 20XX. It is addressed to "ORG-1 member". The letter is excerpted as follows:

"Welcome aboard CO-1. I am sending this information package to help you get started as a club and for the information the IRS insist we have on you. Remember I am here for you, if you have any questions or problems. I am in the office from 10:30 am to 5:00 pm Monday through Friday. Just give me a call and I will be glad to help.

This package should contain:

- Tax Bond Application
- State Tax Registration Application
- Copy of headquarters group ruling
- Guidelines on how to hold a meeting

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- CO-1 constitution, bylaws, and policies
- Membership applications

If this package does not include the above listed items, give me a call.

The letter contains a signature line for Secretary, Administrative Executive.

The January 3, 20XX version of the Master Book contains the most recent version of ORG's Constitution. Aims and Purposes according to Article V of the document named "Constitution of ORG CO-1" are:

Section I.

Within the spirit of our motto, Better Communities Through Patriotism, the CO-1 corporations shall lend its support to all veterans, their families and communities.

Section II.

Uniting fraternally families of Veterans and their communities in order to work together to better the lives of all Veterans and their families and communities and to assist with any difficulties encountered by them, these purposes include but are not limited to the following:

1. sponsor activities that promote patriotism
2. supporting our active military and their families
3. awareness of and assistance to the veterans and families suffering from stress disorders and assimilation back to society
4. present and support the interests of CO-1 before the public and the government
5. providing scholarships for students
6. Sponsor and participate in youth activities.

Article VII of the Constitution addresses Membership. It provides as follows:

Section I.

Chapter Membership

- A. Any person or group of persons wanting to promote patriotism in their community may form a CO-1.
- B. All members of all chapters shall be governed by ORG.

Section II.

Membership Requirement

- A. Any person wanting to show their support for promoting patriotism in their community may join.

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Section III.

Dues

- A. Membership dues must be paid before a member may vote or hold office in any chapter.
- B. Membership dues are to be sent to National Auxiliary within seven days of the member joining.

Article VIII of the Constitution addresses Officers and their duties. Section II specifically addresses "Managing Officer". It provides: "The Managing Officer of the club must be a member of the club. The Manager of the club has full control and supervision of the bar and is accountable for all income and all expenses of the bar. The position may or may not be filled by an Officer of the Board."

This version of the Master Book contains a note advising "Please read the next few pages as they will tell you how to keep your records and what taxes you need to pay. These pages will save you time and money if you have any questions please call me at headquarters"

The "pages" are from Publication 3386 "Tax Guide - Veterans' Organizations" and address issues that relate to Veteran's Organizations that are social clubs and exempt under IRC sec 501(c)(7):

- Membership
- Guests of members at club functions
- Providing sickness, death, and/or similar benefits
- Tax deductibility of membership dues

The Publication was as well excerpted to include:

- Information on unrelated business income and the unrelated business income tax.
- General recordkeeping requirements, as the recordkeeping requirements specifically for member supported section 501(c)(19) organizations have been lined through. The recordkeeping requirements for organizations exempt under sections 501(c)(4), 501(c)(7), 501(c)(8), and 501(c)(10) also included in Publication 3386, is not included in the Master Book.
- Return filing requirements:
  - Form(s) 990/990-EZ
  - Form 990-T
  - Employment Tax Returns
  - Form 1120-POL

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The organization provided meeting minutes for Board meetings held from February 20XX through December 3, 20XX. The meeting minutes detail the organization's activities during this period, and are excerpted as follows:

February 2, 20XX – Board Meeting. New Business: President requested members consider Auxiliary taking responsibilities of support center and note anything it may need to better serve our community. DIR-4 made motion for members to have ideas on what we can do to promote.

April 6, 20XX – Board Meeting. Motion made for Auxiliary to help with the support center, Voted yes. Motion made to find a donation center building or shop. This would be used for collection of goods or household needs. Voted donations would primarily be for support center and disaster victims.

June 1, 20XX – Board Meeting. Thomas motioned a vote by members for the support center to be promoted and to do any necessary actions to promote the center to the community. Voted to accept motion. Board members will visit possible building that may serve as place to make available any donations. Idea to run ad and distribute fliers soliciting items to go to center.

August 5, 20XX – Board Meeting. Organization's officers spoke with small construction company about a building at Address. They and the owner of the CO-21 inspected it. Everything seems in good structural state. Unanimous vote to purchase building for use of support center and possible used for other veteran needs. Board members asked by President to spread work of donation program.

October 5, 20XX – Board Meeting. Building purchased and Auxiliary will maintain promotion, collections and any forms necessary to make decisions as to qualifying hardship needs. Motion to vote on specific space in the building to display donations. A room was agreed upon. Motion to make fliers and run an ad in local paper for support center. Request by President to research forms to use for donations and proof of hardship.

February 1, 20XX – Board Meeting. Board designated room to place donations for support center. 25 fliers were placed around town. Two-week ad placed. Donations have begun coming in. Secretary nominated as Secretary of Board. Nomination carried. Vote unanimous to put Vice President in charge of necessary forms to be completed by displaced veterans and community hardship victims. "Needed ideas for

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ways to promote furniture." DIR-4 asked about time "we" would be available to open our doors to those in need.

April 5, 20XX – Board Meeting. Motion made to move support center donations to room upstairs. Vote approved. Motion and vote that proof of hardship will be fire or disaster verified, those on disability, food stamps, and welfare verifications. Discussion – possibility of going for own exemption. President will research and cover at next meeting.

June 7, 20XX – Board Meeting. Problem obtaining independent exempt status because organization is a sub of CO-1 HQ. Decided against because IRS said under CO-1 umbrella. Support Center donations going well but "not receiving many requests toward response". Any ideas that Board comes up with for getting information out to vets and community will be activated at next meeting.

July 4, 20XX – Board Meeting. Vice President still researching forms to use. Another ad placed in paper for specific locations. City no longer allowing continuation of donation room due to much needed remodeling. Decision pending as to where to move and time lapse for advertising due to relocation. Decision to be made at next meeting.

October 14, 20XX – Board Meeting. Vote to continue advertising the center and placed information forms at stores noting what is available and what to bring to receive. Motion to reapply for group exempt noting new EIN received. Also discussed formation of other chapters and what will be necessary to do this.

March 7, 20XX – Board Meeting. Board discussing making CO-1 Aux Chapters fall under National Aux due to having too many requests for non-members. President is sending request for the change. President said we are getting to many member requests that were veteran family. They could not meet the stringent guidelines of the CO-1 Chapters.

May 9, 20XX – Board Meeting. President reported the IRS had sent a letter stating we cannot receive our exemption because we are under CO-1 HQ umbrella exemption. She explained in detail and a motion was made to go forward in obtaining its own exemption.

July 11, 20XX – Board Meeting. At this time we have not received our group exemption but it looks as if we have finally mailed what IRS wants. President mentioned we need to work on a manual for the ORG. will start working on this project. But she also wants to put together a website.

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September 5, 20XX – Board Meeting. We have received our exemption under 501(c)(4) Social Clubs. is still putting together information for the manual and asks for input as to what may be added to the manual. Building our website.

December 19, 20XX – Board Meeting. Our first chapter was formed in November # of City.

December 19, 20XX – Our 1<sup>st</sup> Chapter was formed in Nov. City.

February 6, 20XX – Board Meeting. Last month we received our status name change. Vice President said our website is coming together and needs ideas for it. Vice President said we are now a 501(c)(4) and do not have to meet required veteran status because our primary activity is to promote patriotism in our community. President said we have received a request at Headquarters to assist the local Army Reserve in sponsoring a women's vet support group. We voted to help in making calls to chapters to see if they are interested.

April 9, 20XX – Board Meeting. A motion was made to assist Headquarters with women's Veteran Support meetings. All voted in favor to make calls and transport vets to meeting if needed. Vice President mentioned the officers' manuals are almost ready and we are getting more requests for new Chapter information. We also discussed that all of us need to get information together for our chapters to be made aware of tax filing procedures.

August 6, 20XX – Board Meeting. Manuals are almost ready. We have added 3 new Chapters and we are updating our website. Motion was made to send newsletters out to inform clubs of what we need to keep our 501(c)(4) status. Voted yes and Vice President will work on this.

October 22, 20XX – Board Meeting. Vice President is handing out officers' manuals and collecting any information needed to assist in chapters filing annual reports to the IRS. Our quarterly 941 is filed with no employees. President motioned to call all chapters to decide the best date for our meeting with chapters.

December 3, 20XX – Board Meeting. A date for Chapter meetings have not been set at this time. A vote was taken to whether we want to continue with our website or not due to expenses. We voted to keep it for now.

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A follow-up conference was conducted with the taxpayers on March 10, 20XX. Secretary, who stated she is primary contact for ORG was interviewed. She provided that ORG was established as an auxiliary to CO-1 for the purpose of accommodating CO-1's "Auxiliary Members" which taxpayers define as spouses of veterans or persons related to veterans within two degrees of consanguinity like Publication 3386 describes, however not necessarily being related to CO-1's veteran members. The change dealt with the "members". CO-1 has a combination of Veteran and Auxiliary members (by its definition of auxiliary). However, CO-1 was getting more and more requests from "chapters" that did not have the membership to meet the membership requirements of a 501(c)(19) Veterans Organization, and as such were requesting membership as an Auxiliary. CO-1 was starting to have too many Auxiliaries, so rather than turning the soliciting entities that did not meet the membership requirements away, CO-1 decided to change the status of its National Auxiliary to what it calls a "501(c)(4) Social Club" that does not require members. Since all of the subs of both the HQ and Auxiliary are bars open to the general public, the parents saw this as an ideal accommodation.

The Board of Directors of CO-1 consists of PRESIDENT, Secretary, and DIR-4 (PRESIDENT's daughter). These individuals make up the current Board of Directors and were the Board of Directors in 20XX. Noting the 20XX return listed Vice President as Vice-President, PRESIDENT advised Volunteer is a "volunteer" over at CO-1.

PRESIDENT confirmed she is the organization's President. She is also a salaried employee advising she only receives a salary when CO-1 is able to pay her one. CO-1 has not paid a salary or any administrative expenses because the Board has not decided how to allocate expenses between the two entities. Secretary is the primary contact person for CO-1. She handles most administrative matters involving the subs such as signing on new chapters, maintaining the organization's web page, answering questions, preparing and mailing newsletters, and new member packets, assuring all subs maintain good standing with the Secretary of State, mailing membership cards, keeping files on the subs including the annual reports, and training office personnel. Recently, Secretary completed an IRS sponsored on-line training course for completion of the new Form 990. Her duties have been extended to preparing the returns for CO-1 and ORG subsidiaries. Secretary was formerly employed by the organization(s), however recently she became a volunteer, coming in to help out when needed (recently for the primary purpose of this exam).

Secretary advised she will be moving to City, State in April 20XX to live with her sister and help her start a 501(c)(3) charity.

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President is the person in charge. Secretary came to work for President at one of her bars before she came to do the administrative duties previously described for CO-1. Currently Secretary is training her replacement who will earn \$/hour full-time with her duties to be split between the 501(c)(19) and 501(c)(4) organizations.

The other employee EMP-1 also makes \$\$/hour for full-time clerical work. The office is officially open 7 days from 11:00 a.m. until 5:00 p.m.

PRESIDENT normally earns \$/week. The organizations have been discussing having her earn \$/hour if the organizations can afford it.

The office "staff" is under the general control and direction of PRESIDENT.

With regard to the "Ten Member Rule", Secretary provided that the requirement is that the subordinate must have 10 members to join the group ruling. The organizations are advised verbally by Secretary that they should increase their veteran membership. This was when they were a 501(c)(19). As a 501(c)(4), the law does not require them to have membership. The "10 member" requirement is that of CO-1. The rule exists because it did with the 501(c)(19) entity.

ORG was prompted to request a change of the status of its subordinates from 501(c)(4) to 501(c)(7) to accommodate the "social" activities of the subs. Since all subs are bars, changing them to 501(c)(7) organizations would accommodate the social activity that is a bar. Note: the organization did not use the term bar, rather the term "club" was used when referencing the subordinates.

Secretary described the benefit of being a part of an exempt organization that supports veterans. She stated that chapters get to be involved in community betterment. She is not sure the word "exempt" even comes up any more. It is all about Patriotism; teaching what that is. Participating in activities of a patriotic nature and assisting veterans and their families. She said at least that is what the subs *should* be doing. However, she admitted there are no controls in place to assure that they are.

When asked how ORG sells membership to prospective subordinates, she provided that by now opportunity for membership in the CO-1 organizations is well known throughout the state. The opportunity has spread through word of mouth. New "clubs" contact CO-1 for additional information. Those who are not made aware by word of mouth access the organization's web page at website. The Alcohol Division has also made reference to CO-1 as well as AMVETS and Vikings memberships as a means for small "clubs" in remote/rural areas to secure a license. Some of the "clubs" were for-

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profit businesses before becoming exempt, some are newly started. The exemption is extended to the "club", not the bar. Therefore ownership is not relevant, as, according to Secretary, the bars are owned by the clubs and not an individual.

The only advantage ORG gets from new members is the annual dues from each of its clubs.

When ORG or CO-1 is contacted by a "club" or someone wishing to start a chapter, they decide which category of exemption the club will fit determined by the club's membership and operations. Once it is determined whether the club will be included as a sub of the 501(c)(4) as opposed to a sub of the 501(c)(19) organization, Secretary, who is the primary contact for the "social clubs" (ORG) and its subs sends out an information packet. The chapter is then asked to schedule a face to face meeting at CO-1 and CO-1's office in (a telephone conference is allowed, but not recommended by the Parent organizations) to go over the packet contents and make sure all documents are complete and correct. Once the dues and membership (for at least ten members) is paid, blank membership cards are mailed to the chapter.

Membership dues are \$ annually. Additionally, the subs are required to remit \$ for each new member (\$ for each returning member). Clubs may charge as much as \$ for membership, however the organization only requires the \$ new and \$ returning member fee. The clubs may keep the rest.

Referencing the subordinate list provided by ORG on March 3, 20XX, (the taxpayer had 15 active subordinates (two on the list are marked "closed"). The 15 are:

- CO-5
- CO-6
- CO-7
- CO-8
- CO-9
- CO-10
- CO-11
- CO-12
- CO-13
- CO-14
- CO-15
- CO-16
- CO-17
- CO-18

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- CO-19

ORG maintains administrative files for each of its subordinate chapters. The administrative files were reviewed for all of the active chapters. They all contained the same type of documentation:

- Certificates of Incorporation issued by the State of State
- Request for Chapter Status forms
- Copies of cancelled checks and/or receipts for the Chapter dues
- Copies of cancelled checks and/or receipts for payments to the Secretary of State
- Copies of cancelled checks and/or receipts for individual membership dues
- Policy Statements
- Member lists
- Applications for Employer Identification Numbers
- Copies of letters from the IRS (all addressed to the Chapters at ORG's street address in City, State)
- Copies of the membership certificates issued by ORG
- State Retail Sales Licenses stamped "Liquor Control Copy"

All of the files contained the above information. Some of the files contained additional information warranting further noting.

#### CO-6

In addition to the information bulleted above, the administrative file for this organization contains:

- A photocopy of the State driver's license of RA-1. According to the information in the file, RA-1 is the entity's President.
- A picture of the front of a building. The window of the building has what appear to be five stickers on it. Each sticker contains a word which as placed spell out "CO-6".
- A form entitled "20XX Activity Report Form for CO-1 of \_\_\_\_\_". "CO-6" is handwritten in the blank. The form is marked received October 27, 20XX by Secretary. The form advises that in order to maintain 501(c)(4) status and track the amount of gross income and prevent *overpayment* of taxes, the entities should keep records to show (the following is taken verbatim from the form):
  - Sources of gross income (record should show if it was received from member or non member. An easy way to do this is to put members sales on a different key on the register)

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- Deductions and expenses related to each activity
- Keep copies of these records for your corporation, National Headquarters, and the IRS
- All clubs are to meet at least four times a year. When does your club hold its meetings? (The form goes on to request a copy of the meeting minutes.)
- The 20XX Activity Report goes on to address the activities of the entity that promote patriotism. The information is provided as a question, then answer as follows:
  - What did your chapter do to sponsor activities that promote patriotism? Answer: Heard of a Vets family member was sick, and held a benefit for him.
  - How does your chapter promote awareness of and assist veterans & their families suffering from stress disorders? Answer: We let Vets know we are here to listen and relax with our sound system on Friday and Saturday night.
  - What does your chapter do to assist the unemployed or homeless veterans and their families? Answer: The Vets family member that is sick, is also homeless. Donated \$.
  - In what way does your chapter sponsor and participate in youth activities? Answer: Donated things to be auctioned off for the Happy Feet Program.
  - Has your chapter participated in "Operation Adopt a Unit"? If so, who and where? What did you do? Answer: We are not for sure what this means.
- A Form, "Minutes of the Meeting of CO-1 of \_\_\_\_\_". "CO-6" is handwritten in the blank, as well as the remainder of the form. The minutes are marked received October 27, 20XX by Secretary. The duration of the meeting was 6:00 p.m. to 7:00 p.m. on October 1, 20XX:
  - **Old Business:** "Never held a meeting until now. Everyone agrees on almost everything."
  - **New Business:** "RA-1 wanted to resign. So we placed new officers and disgusted our next fun raiser which everyone is supposed to be making suggestions."
  - **Discussion:** "Some suggestions for a fund raiser were to have a bake sale or another auction and donating it to Happy Feet program."

The administrative file contained no other meeting minutes, or any documentation that evidenced any other meetings having taken place. None of the administrative files for any of the other entities contain any such meeting minutes.

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- CO-1 Application for Membership Forms; thirty-three completed forms, with respect to some of the applicants, accompanied by copies of Department of Defense Forms DD 214 for some of the member applicants, as well as military ID cards and copies of cards certifying Veteran status.

### CO-5

The entity was incorporated on April 23, 20XX as "CO-5". According to its Articles, the corporation was formed for the purpose of entertainment for charitable events. On April 30, 20XX, the Articles were amended to change the name of the entity to CO-5. Its purpose as amended is to sponsor activities that promote patriotism support active military and their families, sponsor and participate in youth activities.

The entity's administrative file contains a copy of the State Driver's License of RA-2, the entity's President.

The file also contains ten completed membership application forms, including one completed by RA-2. There are three other applications completed by or for persons also named "RA-2".

Except as noted, there was nothing in the file that spoke to the activities of the organizations.

## LAW AND ANALYSIS

### Tax Exemption - Veterans Organizations

Prior to the enactment of I.R.C. § 501(c)(19) by Public Law 92-418, 1972-2 C.B. 675, many veterans organizations qualified for exemption from federal income tax under I.R.C. § 501(c)(4) because most of the traditional activities of these organizations were recognized by the IRS as primarily promoting social welfare. Staff of Joint Comm. on Taxation, 109<sup>th</sup> Cong., Historical Development and Present Law of the Federal Tax Exemption for Charities and Other Tax-Exempt Organizations, JCX-29-05 NO 8, (Comm. Print 20XX). The traditional activities of veterans organizations that were social welfare organizations included promoting patriotism, preserving the memory of those who died in war, and assisting veterans in need. *Id.* A veterans organization whose primary activity consisted of operating social facilities for its members was not able to qualify for exemption as a § 501(c)(4) social welfare organization, but it could qualify as a social club under § 501(c)(7). Rev. Rul. 66-150, 1966-1 C.B. 147; S. Rep. No. 1082, 92d Cong., 2d Sess. 2 (1972) reprinted in 1972-2 C.B. 713; H.R. Rep. No. 851, 92d Cong., 2d Sess. 1 (1972).

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### The Section 501(c)(4) Requirements

Section 501(c)(4) of the Internal Revenue Code grants exemption to "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)(i) of the Regulations describe the promotion of social welfare as being primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements.

Section 1.501(c)(4)-1(a)(2)(ii) of the Regulations provides the promotion of social welfare does not include operating a social club for the pleasure, benefit or recreation of its members, or carrying on a business with the general public in a manner similar to organizations operated for profit.

Rev. Rul. 68-46, 1968-1 C.B. 260 describes a veteran's post. After an analysis of the facts and circumstances, the Service determined that the post's primary activity was the conduct of a business rather than a 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 social welfare programs were not its primary activity.

Rev. Rul. 66-150, 1966-1 C.B. 147, considers the exemption of a subsidiary of a veterans' organization described in section 501(c)(4) of the code. The subsidiary's primary purpose is to operate social facilities for members of the veterans' organization and their guests including a bar, restaurant and game room. It was held that this subsidiary does not qualify as an organization described in section 501(c)(4). The rationale for this ruling is that the subsidiary organization engages in no social welfare activities and its primary purpose is operating a social club.

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

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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 purposes 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.

### The Section 501(c)(19) Exemption Requirements

#### In General

Section 501(c)(19) of the Internal Revenue Code provides for the exemption from federal income tax of a post or organization of past or present members of the United States Armed Forces if it is:

- (a) Organized in the United States or any of its possessions,
- (b) At least 75 percent of its members are past or present members of the Armed Forces of the United States,
- (c) substantially all of its other members are individuals who are cadets or are spouses, widows, widowers, ancestors or lineal descendants of past or present members of the Armed Forces of the United States or of cadets, and
- (d) No part of the net earnings of which inures to the benefit of any private shareholder or individual.

#### Membership Requirements

Under I.R.C. § 501(c)(19), at least 75 percent of an organization's members must be past or present members of the Armed Forces of the United States ("veterans"). Section 501(c)(19) does not define the term "Armed Forces of the United States." The regulations under I.R.C. § 501(c)(19), likewise, do not define the term. Section 7701(a)(15) of the Code, however, defines "Armed Forces" to include all regular and reserve components of the uniformed services which are subject to the jurisdiction of the Secretary of Defense, the Secretary of the Army, the Secretary of the Navy, or the Secretary of the Air Force, and the Coast Guard.

In addition, I.R.C. § 501(c)(19)(B) requires that substantially all other members of an organization be cadets or spouses, widows, widowers, ancestors, or lineal descendants

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of veterans or cadets. According to the Senate Report accompanying the legislation, "substantially all" means 90 percent. See S. Rep. No. 1082, 92<sup>nd</sup> Cong. 2d Sess. 5 (1972), reprinted in 1972-2 C.B. 713, 715. Therefore, of the 25 percent of the members that do not have to be veterans, 90 percent must be cadets, or spouses, etc. Consequently, no more than 2.5 percent (10% x 25%) of an I.R.C. § 501(c)(19) organization's total membership may consist of individuals not mentioned in the statute.<sup>1</sup>

Neither, I.R.C. § 501(c)(19), its legislative history, nor the regulations under I.R.C. § 501(c)(19) define what it means to be a member of a veterans organization. However, whatever the organization requires for one to become a member, the organization must maintain records tracking who its members are and the proportions in the various categories of membership permitted under I.R.C. § 501(c)(19)(B) (member of armed forces, cadet, relative, etc.) to substantiate that its members are veterans or other permitted members. See I.R.C. § 6001 and Treas. Reg. § 1.6001-1(c).<sup>2</sup>

### Operational Test

Section 1.501(c)(19)-1(c) of the regulations provides that an organization exempt under I.R.C. § 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) of the regulations,

\* \* \* \*

<sup>1</sup> Prior to 2003, ancestors and lineal descendent were not included in the statutory list of persons permitted to be members. In 2003, Congress amended I.R.C. § 501(c)(19) to include ancestors or lineal descendents of present or former members of the United States Armed Forces or cadets in the statutory list of individuals who may be members of an organization. The regulations have not been updated to reflect this change nor do they reflect the 1982 statutory change eliminating a requirement that veterans be veterans of war.

<sup>2</sup> Section 6001 of the Code 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 of his delegate may from time to time proscribe. Every organization exempt from tax under § 501(a) and subject to the unrelated business income tax, including veterans organizations, must keep such records. Treas. Reg. § 1.6001-1(a). These books and records are required to be available for inspection by the Service. Treas. Reg. § 1.6001-1(a). In addition, veterans organizations are required to keep books and records to substantiate information reported on their information return. See I.R.C. § 6033 and Treas. Reg. § 1.6001-1(c). They are also required to submit additional information to the Service for the purpose of enabling the Service to inquire further into its exempt status.

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- 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.

Treas. Reg. § 1.501(c)(19).

### Social and Recreational Activities for Members

While Treas. Reg. § 1.501(c)(19)-1(c)(8) does not address what it means to "exclusively" provide social and recreational activities for members it is similar to the exempt purpose contained in I.R.C. § 501(c)(7), as both provisions permit an exempt organization to operate social and recreational facilities for its members. In fact, prior to the enactment of I.R.C. § 501(c)(19), a veterans organization whose primary activity consisted of operating a bar or restaurant for the benefit of its members would have to qualify as § 501(c)(7) social club to be tax-exempt. See Rev. Rul. 60-324 and Rev. Rul. 69-219.<sup>3</sup> These organizations, prior to 1976, were required to operate "exclusively" for the pleasure and recreation of its members. See I.R.C. § 501(c)(7) (1975). Thus, the

\* \* \* \*

<sup>3</sup> In 1976, Congress amended § 501(c)(7) replacing "exclusively" with "substantially all." This change was effected to establish that social clubs will not jeopardize their exempt status if they receive 35% of their gross receipts from non-membership sources. Only 15% of their gross receipts, however, may be derived from nonmembers' use of club facilities or services. Pub. L. No. 92-568, S. Rep. 1318, 94 Cong., 2d Sess. (1976).

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rulings and case law under I.R.C. § 501(c)(7) are useful for purposes of determining whether an I.R.C. § 501(c)(19) veterans organization is providing social and recreational activities exclusively for its members.

Treas. Reg. § 1.501(c)(7)-1(b) provides that a club that engages in business, such as making its social and recreational facilities available to the general public is not organized and operated exclusively for pleasure, recreation, and other nonprofit purposes, and is not exempt under I.R.C. § 501(a). Solicitation by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the club is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes.

In West Side Tennis Club v. Commissioner, 111 F.2d 6 (2<sup>nd</sup> Cir. 1940), cert. denied, 311 U.S. 674 (1940), the Second Circuit upheld the board of tax appeals determination that a social club was not exempt because a substantial amount of its income was received from the general public. West Side Tennis Club was organized to provide tennis facilities for the use and enjoyment of its members. The facilities were only available to members for most of the year; the club hosted annual national championship tennis matches, however, that were open to the general public. The club shared in the ticket proceeds from these matches. The Second Circuit upheld the board of tax appeals determination that the national championship matches were a substantial and profitable business which jeopardized the club's exemption. West Side Tennis Club, 111 F.2d at p. 7.<sup>4</sup>

In Rev. Rul. 60-324, 1960-2 C.B. 173 and Rev. Rul. 69-219, 1969-1 C.B. 153, the Service held that a § 501(c)(7) social club is not operated exclusively for the pleasure or recreation of its members if it makes its facilities available to the general public to a substantial degree. Id. However, this does not mean that all dealings with the general public are necessarily inconsistent with the club's exempt purposes. For instance, in Rev. Rul. 60-324, 1960-2 C.B. 173, the Service stated that:

[w]hile [the] regulations indicate that a club may lose its exempt status if it makes its facilities available to the general public, [it] does not mean that any dealings with outsiders will automatically cause a club to lose its

\* \* \* \*

<sup>4</sup> In 1976, Congress amended § 501(c)(7) replacing "exclusively" with "substantially all." This change was effected to establish that social clubs will not jeopardize their exempt status if they receive 35% of their gross receipts from non-membership sources. Only 15% of their gross receipts, however, may be derived from nonmembers' use of club facilities or services. Pub. L. No. 92-568, S. Rep. 1318, 94 Cong., 2d Sess. (1976).

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exemption. A club will not lose its exemption merely because it receives some income from the general public, that is, persons other than members and their bona fide guests, or because the general public may occasionally be permitted to participate in its affairs, provided such participation is incidental to and in furtherance of its general club purposes and the income there from does not inure to members.

In 1971, the Service issued Revenue Procedure 71-17, 1971-1 C.B. 683, which contains guidelines for determining the impact of an organization's nonmember gross receipts on its exempt status under I.R.C. § 501(c)(7). The revenue procedure provides that "[a] significant factor reflecting the existence of a nonexempt purpose is the amount of gross receipts derived from use of a club's facilities by the general public." The revenue procedure went on to provide a safe harbor for organizations serving the general public:

As an audit standard, [the gross receipts derived from the general public] alone will not be relied upon by the Service if annual gross receipts from the general public for [use of the club's facility] is \$2,500 or less or, if more than \$2,500, where gross receipts from the general public for use is five percent or less of total gross receipts of the organization.

Rev. Proc. 71-17, 1971-1 C.B. 683 at § 3.01.

The term "general public" is defined as persons other than members or their dependents or guests. Id. at § 2.01. Section 3.03 of Rev. Proc. 71-17 provides four instances in which nonmembers are assumed to be the guests of the members. The assumptions include:

Where a group of eight or fewer individuals, at least one of whom is a member, uses club facilities, it will be assumed for audit purposes that the nonmembers are the guests of the member, provided payment for such use is received by the club directly from the member or the member's employer.

Where 75 percent or more of a group using club facilities are members, it will likewise be assumed for audit purposes that the nonmembers in the group are guests of members, provided payment for such use is received by the club directly from one or more of the members or the member's employer.

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Rev. Proc. 71-17, Section 3.03.

In Pittsburgh Press Club v. United States, 615 F.2d 600 (3<sup>rd</sup> Cir. 1980), the Third Circuit upheld the Commissioner's determination that a social club failed to qualify for exemption from income tax as a §501(c)(7) organization because it was operated for business and not for the pleasure and recreation of its members. The Pittsburgh Press Club was organized for the purpose of providing a professional and social meeting place for its members. During the years under exam, however, the Pittsburgh Press Club hosted several functions for nonmember outside groups, although each such group had been member sponsored. Based on the amount of nonmember revenues (\$281,000 of nonmember receipts), as well as the percentage of those revenues (11 to 17 percent of gross receipts), the Third Circuit upheld the revocation stating that the exemption from Federal income tax for §501(c)(7) organizations "is to be strictly construed." Pittsburgh Press Club, 615 F.2d at 606. The Court stated that such strict construction cannot be reconciled with the fact that a substantial amount of the Club's activities and income consisted of nonmember functions and nonmember income. Therefore, the Court held "revocation of its exemption was proper." Id.

### The Section 501(c)(7) Exemption Requirements

Section 501(a) of the Internal Revenue Code exempts from taxation organizations described at subsection 501(c)(7) as clubs organized for pleasure, recreation, and other non-profitable purposes, substantially all of the activities of which are for such pleasure, recreation, and other non-profitable purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

Section 1.501(c)(7)-1 of the Income Tax Regulations states in pertinent part, that:

- (a) The exemption provided by § 501(c)(7) of the code applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, but does not apply to any club if any part of its net earnings inures to the benefit of any private shareholder. In general, this exemption extends to social and recreation clubs that are supported solely by membership fees, dues, and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenue from members through the use of club facilities or in connection with club activities.
- (b) A club, which engages in business, such as making its social and recreational facilities available to the general public or by selling real estate, timber, or their products, is not organized and operated exclusively for pleasure, recreation, or social purposes.

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Section 501(c)(7) was amended in 1976 by P.L. 94-568 to provide that section 501(c)(7) organizations could receive some outside income, including investment income, without losing their exempt status. Prior passage of this law in 1976, section 501(c)(7) of the Code provided exemption for social clubs organized exclusively for pleasure, recreation, and other non-profitable purposes. P.L. 94-568 substitutes the word "substantially" for "exclusively".

Both Senate and House Committee Reports show that this wording change was intended to make it clear that social clubs may receive outside income, without losing their exempt status. However, the committee reports also specified clearly defined limits on this outside income, which if exceeded then invoke the application of a facts and circumstances test. The law allows social clubs to receive up to 35% of their gross receipts, including investment income, from sources outside their membership without losing their exempt status. Within this 35%, no more than 15% of gross receipts may be derived from non-member use of club facilities and/or services. (S. Report No. 94-1318 (1976), 2d Sess., 1976-1 C.B. 597; H. Report No. 94-1353, to accompany H. Report 1144 (Public law 94-568, 3-4, 8 (1976)).

United States v. Fort Worth Club, 5 Cir. 345 F. 2d 52, 55 read in part, "We begin with the general proposition that tax exemptions, except those of charitable organizations, are to be construed strictly." The courts further provided that the legislative history urges a particularly strict construction for the exemption of social clubs. Thus only a limited number of facts and or circumstances warrant continued exempt status where the percentage of non-member income exceeds the percentage guidelines.

Pittsburgh Press Club v. U.S., 536 F2d (1976); 579 F.2d 751 (1978); and 615 F2d 600 (1980), that a substantial portion of the club's total receipts was from non-member use of a club's facilities (determined between 11 - 17% of gross income) indicated to the court that the club was engaged in business with the general public. Other factors noted by the court to consider in addition to the level of non-member income include:

- a) The purposes for which the club's facilities were made available to non-member groups,
- b) The frequency of use of the club facilities or services by nonmembers; and
- c) The amount of net profits derived from non-member income.

The audit standards described in Revenue Procedure 71-17 as discussed above are applicable as well for this type of member organization.

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### Other Applicable Provisions

#### Record Keeping and Information Retention Requirements:

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

Section 6033(a)(1) of the Code provides, except as provided in section 6033(a)(2), every organization exempt from tax under section 501(a) shall file an annual return, stating specifically the items of gross income, receipts and disbursements, and such other information for the purposes of carrying out the internal revenue laws as the Secretary may by forms or regulations prescribe, and keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Secretary 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 provisions 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 exempt status.

#### Group Exemptions – Revenue Procedure 81-27:

Revenue Procedure 81-27 sets forth the procedures under which recognition of exemption from federal income tax under section 501(c) of the Internal Revenue Code

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may be obtained on a group basis for subordinate organizations affiliated with and under the general supervision or control of a central organization.

Paragraph three (3) of the Revenue Procedure defines provides the definitions of group exemption letter, central organization and subordinate:

- 01 A group exemption letter is a ruling or determination letter issued to a central organization recognizing on a group basis the exemption under section 501(c) of the Code of subordinate organizations on whose behalf the central organization has applied for recognition of exemption in accordance with this revenue procedure.
- 02 A central organization is an organization that has one or more subordinates under its general supervision or control.
- 03 A subordinate is a chapter, local, post, or unit of a central organization. It may or may not be incorporated, but it must have an organizing document. A central organization may be a subordinate itself, such as a state organization which has subordinate units and is itself affiliated with a national organization.

Paragraph four (4) of Revenue Procedure provides the requirements for inclusion in a group exemption letter:

- 01 A central organization applying for a group exemption letter must obtain recognition of its own exempt status.
- 02 It must also establish that the subordinates to be included in the group exemption letter are:
  - 1. Affiliated with it;
  - 2. Subject to its general supervision or control;
  - 3. All exempt under the same paragraph of section 501(c) of the Code, though not necessarily the paragraph under which the central organization is exempt;
  - 4. Not private foundations, if the application for a group exemption letter involves section 501(c)(3);
  - 5. All on the same accounting period as the central organization if they are to be included in group returns; and
  - 6. Organizations that have been formed within the 15-month period prior to the date of submission of the group exemption application, if they are claiming section 501(c)(3) status and are subject to the requirements of section 508(a), and wish to be recognized as exempt from their dates of creation. A group exemption letter may be issued covering subordinates, one or more of which have not been organized within the 15-month period

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prior to the date of submission if all subordinates are willing to be recognized as exempt only from the date of application.

- 03 .Each subordinate must authorize the central organization to include it in the application for the group exemption letter. The authorization must be signed by a duly authorized officer of the subordinate and retained by the central organization while the group exemption letter is in effect.

Section 6 of the Revenue Procedure provides for the information required annually to maintain a group exemption letter including the records and information listed at Section 5.03, subparagraphs 1a through h:

- (a) information verifying the existence of the relationships required by section 4.02;
- (b) a sample copy of a uniform governing instrument (charter, trust indenture articles of association, etc.) adopted by the subordinates; or, in the absence of a uniform governing instrument, copies of representative instruments;
- (c) a detailed description of the purposes and activities of the subordinates including the sources of receipts and the nature of expenditures;
- (d) an affirmation that, to the best of the officer's knowledge, the purposes and activities of the subordinates are as set forth in (b) and (c) above;
- (e) a statement that each subordinate to be included in the group exemption letter has furnished written authorization to the central organization as described in section 4.03;
- (f) a list of subordinates to be included in the group exemption letter to which the Service has issued an outstanding ruling or determination letter relating to exemption;
- (g) if the application for a group exemption letter involves section 501(c)(3) of the Code, and is subject to the provisions of section 508(b), an affirmation to the effect that, to the best of the officer's knowledge and belief, no subordinate to be included in the group exemption letter is a private foundation as defined in section 509(a); and
- (h) for each subordinate that is a school claiming exemption under section 501(c)(3), the information required by Rev. Proc. 75-50, 1975-2 C.B. 834. Also, there must be included such other information necessary to establish that the school is complying with the requirements of Rev. Rul. 71-447, 1971-2 C.B. 230.

Section 7 of the Revenue Procedure, outlines the circumstances under which the group exemption letter will cease to have effect, and includes when the Service notifies the central organization or the affected subordinate that the group exemption letter shall

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cease to have effect as to some or all of the group because the conditions set out in .01 or .02 of this section have not been fulfilled:

01 Continued effectiveness of a group exemption letter is based on the following conditions:

1. continued existence of the central organization;
2. continued qualification of the central organization for exemption under section 501(c) of the Code;
3. annual submission by the central organization of the information required by section 6; and
4. annual filing by the central organization of an information return if one is required of it under section 6033.

02 Continued effectiveness of a group exemption letter as to a particular subordinate is based on the conditions set out in .01 of this section and the following conditions:

1. continued conformity by the subordinate to the requirements for group exemption set out in SEC. 4.02 and 4.03; and
2. annual filing of an information return for the subordinate if one is required of it under section 6033 of the Code.

**ORG Financial Information**  
Form 990

	20XX	20XX <sup>5</sup>	20XX
<b>Revenue</b>			
Membership Dues			
Gross Sales of Inventory			
Less: Cost of Goods Sold			
Equals: Net Sales			
<b>TOTAL REVENUE</b>			

**Expense**

Benefits Paid to or for Members  
Salaries, Compensation, Benefits  
Occupancy, Rent, Utilities, Maintenance  
Printing, Publications, Postage, Shipping  
Truck Upkeep, Bank Fees, Taxes, Office

\* \* \* \*

<sup>5</sup> The taxpayer filed Form 990-N "Electronic Notice (e-Postcard) for Tax-Exempt Organizations Not Required to File Form 990 or 990-EZ, if they choose not to file Form 990 or Form 990-EZ.

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Equipment, Secretary of State Fees  
**TOTAL EXPENSE**  
*Excess or Deficit)*

**Financial Records**  
**Bank Statements**

The taxpayer's financial records consists only of Bank Statements Drawn on CO-20, Address, City, State Checking Account Number and was only made available for the 20XX examination period.

The deposits entered into the account are identified as either "BANKCD", or "DDA Regular Deposit".

A deposit analysis for the checking account provides as follows:

Beginning Bank Balance	\$
Deposits	
Funds Available	
Ending Balance	()
Cost of Goods Sold	\$

**Taxpayer's Position**

The taxpayer's position is outlined in Exhibit N, "Answers and Inconsistency to the Issues on Form 886" (2 pages containing 24 listed items).

**Government's Position**

The Government's position is noted in Exhibit O (9 pages) addressing each of ORG's 24 itemized concerns.

**Issue 1--Analysis**

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. Ruls. 66-221 and 68-45, the fact that the organizations engaged in some activities characterized as business with the general public preclude a finding that they were nevertheless described in

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section 501(c)(4). An analysis of these organizations as a whole showed that the business of operating the fire departments and conducting veterans' activities, (activities that directly benefit the community as a whole) were the organizations' "primary" activities. On the other hand, a business activity conducted as the organization's primary activity precludes exemption under section 501(c)(4) of the code. Thus, in Rev. Ruls. 68-46 and 61-158, 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 are 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 a 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.

ORG was recognized as exempt under section 501(c)(4) of the Code. Subsequently, it received recognition as a Central organization and assigned group exemption number 5411 maintaining its recognition as an organization described at section 501(c)(4) of the Code, as well as its subordinates.

The timeline, prepared from documentation provided by the taxpayer, offers that the taxpayer was originally formed as CO-1, EIN, as a subordinate of CO-1 and exempt under IRC section 501(c)(19). Its transition to ORG, EIN, a Central Organization exempt under section 501(c)(4) began when the taxpayer changed its name from CO-1 (incorporated January 1, 19XX) to ORG on August 9, 19XX. The taxpayer was advised [despite having changed its name] that it is exempt under § 501(c)(19) as a subordinate of CO-1, under group exemption number (GEN) effective November 19XX.

On May 17, 20XX, the IRS notified the taxpayer that it failed to include its EIN on Form 941 for the 20XX03 tax period, and that there was no record of an EIN being assigned to the organization. As such the taxpayer was assigned EIN for the purpose of processing the return only. The taxpayer was advised that if it already had an EIN, that it should complete a form attached to the letter and return it to the IRS along with the name the exact name associated with the EIN. In accordance with the instruction, the taxpayer should have returned EIN and the name CO-1. Under the name ORG, the taxpayer applied for a new EIN and on October 10, 20XX was assigned EIN. On

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November 27, 20XX the taxpayer used the new name and EIN to receive a favorable determination as an IRC § 501(c)(4) organization. The effective date of the exemption is June 19XX. June 16, 20XX the taxpayer received Articles of Amendment changing its name to *ORG*.

The information the taxpayer provided to the IRS as part of its application for recognition as a Central Organization listed CO-1 as its first subordinate. After being advised by the IRS that CO-1 is already exempt as a subordinate of CO-1 and is recognized as exempt under GEN , the taxpayer advised that the name of the subordinate would be changed to CO-3 Auxiliary, its purpose according to the taxpayer, "to sponsor activities that promote patriotism, supporting active military and their families, to sponsor and participate in youth activities." The facts provide the subordinate's activities as being consistent with a veteran's organization exempt under § 501(c)(4) of the Code. The IRS advised the taxpayer of the favorable ruling to recognize the taxpayer's subordinates as IRC § 501(c)(4) organizations.

The result of the analysis of the information provided by the taxpayer is that its minutes contain the only specific information available regarding its activities. The board meeting minutes also chronicle the taxpayer's migration to becoming a Central Organization after having received an independent ruling as an organization exempt under IRC § 501(c)(4). The December 19, 20XX meeting minutes contradict the information the taxpayer provided to the IRS in its application for a group ruling, as the minutes provide that the organization's *first* chapter was formed in November, # City, and was not CO-3 as it indicated in its application.

The taxpayer provided its meeting minutes for the period spanning February 2, 20XX through December 3, 20XX, which includes the examination period that begins January 1, 20XX and ends December 31, 20XX. Board meetings, which are recorded verbatim in the "Facts" section of this report, equaled 5 hours in 20XX; 4 hours and 35 minutes in 20XX; and 5.5 hours in 20XX. The taxpayer is open 7 days a week for six hours each day, therefore the taxpayer devotes (accommodating the Thanksgiving, Christmas, and New Year holidays) less than 1% of its time to meetings and planning. The balance of its time is spent on administrative matters concerning its subordinates as described by Secretary.

The Code first requires exempt organizations to keep permanent books or accounts or records as are sufficient to establish the amount of income, deductions, credit and other matters required to be shown in any return of tax; and secondly to keep, at all times available for inspection by authorized internal revenue officers or employees, the

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required books and records, and third to maintain such books and records as long as the contents may be material to the administration of any internal revenue law.

The taxpayer maintained few books and records to support having carried out any of the proposed activities recorded in the meeting minutes. From the records and information available, including the returns filed by the taxpayer for the examination period, and the information obtained from the interview, the taxpayer's activities included attending to the administrative matters of its subordinates, tending to its own administrative matters, and operating an unidentified business enterprise as identified by the financial records.

The facts provide that tending to the administrative matters of its subordinates is the taxpayer's primary activity.

Rationalizing that if the taxpayer spent the primary amount of its time addressing administrative matters of its exempt subordinates that are engaging in activities that promote the taxpayer's exempt purpose, the taxpayer itself is furthering such purpose by this substantial activity.

Revenue Procedure 80-27 addresses the procedures for securing exemption for the subordinates, as well as documentation to be submitted with regard to the qualification of these subordinates as exempt within the meaning of § 501(c)(4) of the Code. As previously indicated, the Code requires that the taxpayer maintain the information as it is the only means by which to measure the taxpayer's qualification for continued exempt status.

The Revenue Procedure provides that as a Central Organization, the taxpayer must establish that the subordinates to be included are: affiliated with it; subject to its general supervision or control; all exempt under the same paragraph of section 501(c) of the Code, though not necessarily the paragraph under which the central organization is exempt; and each subordinate must authorize the Central Organization to include it in the application for the group exemption.

The taxpayer's purpose, according to its Articles of Incorporation, is to unite fraternally the wives of veterans with their husbands belonging to CO-1. To lessen the effects of the Vietnam veteran and their family and all other legal powers permitted general not for profit organizations.

The taxpayer's Aims and Purpose according to the most recent revision of its Constitution is "Within the spirit of our motto, Better Communities Through Patriotism,

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the CO-1 corporations shall lend its support to all veterans, their families and communities.

Uniting fraternally families of veterans and their communities in order to work together to better the lives of all veterans and their families and communities and to assist with any difficulties encountered by them, these purposes include but are not limited to the following:

1. Sponsor activities that promote patriotism
2. supporting our active military and their families
3. awareness of and assistance to the veterans and families suffering from stress disorders and assimilation back to society.
4. present and support the interests of CO-1 before the public and the government
5. providing scholarships for students
6. sponsor and participate in youth activities

In order to accomplish these purposes the taxpayer provided in its exemption application that its subordinates would conduct their activities, devoting % of their time gathering veterans and their families together fraternally and offer support by making phone calls and socials for veterans and their families; % preparing returns and other documents typical of corporate reporting, meetings of officers to discuss activities typical of a § 501(c)(4) organization; and % fundraising by taking donations from members and the public, selling Army surplus, having a thrift store booth, and selling donated items.

As the facts indicate, the taxpayer did not produce any record that any of the activities of its subordinates are consistent with the activities it implied their subordinates would conduct. Additionally, the taxpayer did not produce any record that it had the control and affiliations required for exemption. Each of the organizations did sign a request in some form to be included in the taxpayer's exemption letter.

Further, the statements offered by the taxpayer during the noted interviews revealed that the primary activity of its subordinates is the operation of a bar. In fact, the taxpayer, by its own admission sought and obtained an independent exempt status in order to accommodate the failure of these bars to meet the strict member requirements of its previous § 501(c)(19) status, and to accommodate the intense social activities, that is, operating a bar.

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The taxpayer's web page which it shares with former parent, CO-1, lists among the advantages of being included in the taxpayer's group exemption, selling liquor on Sunday, holding bingo games, obtaining liquor licenses in dry counties. The web page advises potential subordinates that the taxpayer will assist in the club's formation, and application for liquor license.

The taxpayer's statements also provide when asked what it provides in exchange for the membership dues paid by its subordinates, the administrative services provided its subordinates, preparing returns, guidance on securing licenses, sales tax exemption, filing returns, etc. is no different than a bookkeeping, accounting, or tax planning service operated commercially.

**Issue 1--Conclusion:**

The law with regard to IRC § 501(c)(4) organizations is clear. The operation of a bar, whether for qualified "war" veteran members, auxiliary members, and bona fide guests does not serve to promote social welfare within the meaning of the § 501(c)(4). The conduct of the business itself, apart from recreation, provides no direct benefit to the community. As such, the business of operating a bar constitutes carrying on a business in a manner similar to entities that are operated for profit.

As the taxpayer's primary activity is to provide administrative services to entities, which by its own admission, and is supported by an analysis of its records, is consistent with a commercially operated establishment that provides such service; and that service is provided to establishments which, again by the taxpayer's own admission, and also supported by the analysis of the books and records, carrying on a business, a bar, in a manner similar to entities operated for profit, the taxpayer does not meet the requirements for continued recognition of exemption under section 501(c)(4) of the Code.

**Issue 2--Rationale:**

The taxpayer's web page, requires its clubs have at least 10 veteran members. It also provides that prospective subordinates send it proof of all veterans' affiliation. In response to whether the bars have to be "members only clubs", the taxpayer acknowledges that the tax advantages of being a members only club are greater (acknowledging that the exemption under this section is intended for membership organizations), yet the taxpayer does not require its subordinates to limit its bar to members. It advises that the bars' doors may be open to the public if the bar chooses

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to do so. The web site also speaks to the independence of the bars, and its lack of control over them by offering that by incorporating, "you keep control of your own club".

The taxpayer's constitution also addresses this ten member rule; yet the document contains no provisions nor does the taxpayer, by its own statements, conduct any follow-up activities to assure that the bars are complying with the membership requirements. The information offered by review of the taxpayer's own administrative files for each of its subordinates provided no information with regard to membership for most of its subordinates. For those organizations that did comply with the constitution and secure members and provide the requested proof of veteran status of the members, the taxpayer's administrative records for these entities did not contain any financial information for any of its subordinates.

An organization described in section 501(c)(19) of the Code carries out activities in furtherance of its exempt purposes only when the activities are carried out exclusively in furtherance of the purposes listed in section 1.501(c)(19)-1(c) of the regulations. Veterans' organizations exempt under § 501(c)(19) of the Code have been permitted broad purposes by Congress. They promote Americanism, sponsor youth activities, provide color guards, conduct patriotic ceremonies and functions, and conduct community activities. Many also conduct social activities *among their members*. Social and recreational activities are only exempt activities if conducted among post members. Such *member exclusive* activities include the operation of a bar and/or restaurant, gambling, and dinners and dances.

Where participation in a § 501(c)(19) organization is 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 transaction (such as restaurant and bar sales), the presumption will be that the organization is not primarily engaged in section 501(c)(19) activities.

**Issue 2--Conclusion:**

The analysis of the facts and circumstance as provided by the taxpayer provided that neither the taxpayer, nor any of its subordinates meet the membership requirements of section 501(c)(19) of the Code. It is this fact that caused CO-1 to form the taxpayer as one of its auxiliaries and later an independently exempt organization with its own group ruling.

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The facts also provide that the taxpayer advised the members that it may conduct business with the general public, requiring only an initial ten members for inclusion in the taxpayer's group exemption. As such the presumption is that for the two organizations that did follow and in one case exceed the member requirements, that the patronage of the facilities included non-members, however no information was provided to show how receipts from these members compared to total receipts of the bars. The taxpayer did not show that its subordinates met the record keeping requirements of Revenue Procedure 71-17, when the fact provide the taxpayer was certainly aware of them.

During the years under examination the taxpayer had no permanent mechanism in place to maintain records to show that its subordinates took steps to distinguish between income from veterans and non-veteran income, social members, and income from the general public derived from the bar. In fact, again the facts support that it was this record keeping requirement that the taxpayer was attempting to negate by reforming itself as a § 501(c)(4) organization.

Generally, if an organization has not kept adequate books and records concerning its financial transactions with non-members and more than 50 percent of its gross receipts are derived from sales transactions, 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.

As there is no information in place as to the exact income of the taxpayer's subordinates with regard to their activities, including the bar activities, the subordinates would not qualify for exemption under § 501(c)(19) of the Code.

As the taxpayer's primary activity is to provide administrative services to entities, which by its own admission, and is supported by an analysis of the facts and its records, is consistent with a commercially operated establishment that provides such service; and that service is provided to establishments which, again by the taxpayer's own admission, and also supported by the analysis of the books and records, carrying on a business, a bar, in a manner consistent with entities operated for profit, the taxpayer does not meet the requirements for consideration of exemption under section 501(c)(19) of the Code.

**Issue 3--Rationale:**

As organization's exempt under section 501(c)(7), the taxpayer would be required to maintain records to establish that it, and each of its subordinates so classified, meet the

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IRC § 501(c)(7) membership requirements. Clearly the taxpayer, and for the most part, its subordinates do not meet such requirement, as per the taxpayer such is the reason it sought exemption under § 501(c)(4), converting from an organization recognized under § 501(c)(19).

The difficulty with the taxpayer being classified under section 501(c)(7) of the Code is that it would need to maintain records showing the use of the bars (member, auxiliary member, bona fide guest and nonmember use). See Rev. Proc. 71-17, and section 6001 of the Code. Exemption under § 501(c)(7) of the Code limits the receipts of non-member income from the use of club facilities to 15% of total gross receipts. The taxpayer maintained no records showing non-member use, or income received from either *members* or *non-members*, therefore it can not be ascertained what if any qualifies as non-taxable income.

**Issue 3--Conclusion:**

The taxpayer has not established that neither it nor its subordinates meet the provisions for exemption under § 501(c)(7) of the Code.

**Conclusion:**

Pursuant to the conclusions noted above. The taxpayer does not qualify for continued exemption under section 501(c)(4) of the Code because it has not been established that the taxpayer is primarily engaged in social welfare activities within the meaning of the statute. The facts do not support that the subordinate organizations of the taxpayer operate within the meaning of section 501(c)(4), and therefore the taxpayer's administrative services afforded these subordinates are no different than those offered by a firm whose primary trade or business is the offering of such services.

The facts as well do not support the taxpayer's qualification for continued exemption under either sections 501(c)(19) and 501(c)(7) of the Code, as the taxpayer by its own admission does not meet the membership requirements for such exempt status. Additionally, the facts do not support that any of the taxpayer's subordinate organizations meet either the membership requirements of either section of the Code.

It is therefore proposed that the exempt status granted ORG under section 501(a) of the Internal Revenue Code as an organization described in § 501(c)(4) be revoked. The effective date of the revocation is January 1, 20XX.

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As a taxable entity, you are required to file Form 1120 "U.S. Corporation Income Tax Return". For additional information for filing the income tax return, please consult Form 1120 Instructions.