



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
1100 Commerce Street  
Dallas TX 75242

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

**UIL: 501.02-01**

**Date: April 9, 2009**

Number: **201338045**

Release Date: 9/20/2013

**LEGEND:**

**ORG = Name of Organization**

**ADDRESS = Address of Organization**

**Year =xx**

**Employer Identification**

**Person to Contact/ID Number:**

**Contact Numbers:**

**CERTIFIED MAIL**

Dear :

In a determination letter dated October 19xx, you were held to be exempt from Federal income tax under Internal Revenue Code § 501(c)(2).

We have determined you have not operated in accordance with the provisions of Internal Revenue Code § 501(c)(2). We have explained the basis for our determination in the enclosed report of examination.

On February 24, 20xx you signed Form 6018-A, Consent to Proposed Action, agreeing to the revocation of your exempt status under section 501(c)(2) of the Code. Therefore, your exemption from Federal income tax is revoked effective July 1, 20xx.

You are therefore required to file Form(s) 1120, Federal Corporate Income Tax Return, for the year(s) ended June 30, 20xx, and 20xx, with the Ogden Service Center. For future periods, you are required to file Form 1120 with the appropriate service center indicated in the instructions for the return.

You have the right to contact the Office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal Appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have

been resolved through normal channels gets prompt and proper handling. You may call toll-free, 1-877-777-4778, and ask for Taxpayer Advocate Assistance.

If you prefer, you may contact your local Taxpayer Advocate at:

Internal Revenue Service

This is a final adverse determination letter with regard to your status under IRC § 501(c)(2).

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

Sincerely,

Sunita B. Lough  
Director, EO Examinations

Enclosures:

Report of Examination  
Copy of Form 6018-A

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer <b>ORG</b> <b>NUM</b>		Year/Period Ended June 30, 20xx June 30, 20xx

**LEGEND:**

ORG = Name of Organization

Num= Identifying Number

RELATED ORG = Name of Related Organization

ADDRESS = Address of Organization

Year = xx

**ISSUE:**

Whether The ORG,            qualifies for tax exemption under Section 501(c)(2) of the Internal Revenue Code.

**FACTS:**

The ORG,            (hereinafter referred to as the "Organization"), was incorporated in the state on September 8, 19xx. The state record reflected that this corporation was active and a domestic non profit corporation with the exclusive purpose of holding title to property, collect income there from, and turn over the entire amount thereof, less expense, to RELATED ORG, a non profit organization under Internal Revenue Code Section 501(c)(8). In October 19xx, the organization was granted tax exempt status under section 501(c)(2) of the Internal Revenue Code as a holding company.

According to our records, the organization filed the most recent Forms 990 for the tax period ending June 30, 20xx. The organization had filed Forms 941 for all quarters January 01, 20xx through September 31, 20xx with no balances due.

The organization holds title to two buildings and the property located at ADDRESS

The lease agreement between the organization and the RELATED ORG. entitles the RELATED ORG to use the property at ADDRESS location, which consists of approximately five acres and a lodge facility. The premises shall be used for the purpose of having meetings and other functions . The organization reserved the right to lease the premises to other parties for short terms provided that said leasing to other parties does not interfere with the functions and uses of the RELATED ORG. The rent charged was \$1 per month, payable in advance on or before the first day of each month during the term of the lease. A copy of the lease provided stated the terms commencing on January 1, 19xx and extending through December 31, 20xx. There were no written current leases provided and the organization stated that they continue on a verbal commitment. A review of the books and records for the examined periods July1 20xx through June 30, 20xx did not find the full amount of rents paid or collected between the two parties.

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The property located at Different Address is operated as a bingo hall with the organization holding a valid state hall operator's license. The commercial lease agreement with the Related ORG at this location entitles the RELATED Org to use the facility, utilities, tables, and chairs one day per week for the sole purpose of conducting Bingo, paying \$0 per week as rental of the premises and \$0 per week for janitorial, maintenance, and supply services. The RELATED ORG shall have full authority over any and all food and beverage offerings and operate the kitchen, which is not part of this lease agreement. The bingo hall is rented out to six other non profit organizations for the remainder of the week under similar lease terms with no provisions regarding the kitchen operations. The organization acts as the employer for the employees working at the bingo hall, including the kitchen staff, and at the lodge facilities. They have filed all employment tax returns and paid all employment taxes from January 1, 20xx to present. The Related ORG. previously acted as the employer and filed all employment related returns up through January 31, 20xx.

During review of the operations of the bingo hall, the exam found that the organization was controlling the concession stand, collecting rents, and providing cleaning and maintenance. The RELATED ORG is limited in offering services to non members as a member organization and must use member volunteers to meet the exception for not treating non member income as unrelated business income. They did not operate the concession stand with volunteer members. The organization paid employees under their control to operate the concession stand at the bingo hall seven days a week and also hired a manager to oversee the catering and renting of the hall facilities. They also controlled the members lounge area and paid a bartender to serve the members.

The organization is precluded from receiving any unrelated business income from activities other than collecting rents.

The facilities located at ADDRESS the RELATED ORG's meeting room and offices, in addition to the social area advertised as the Room on their website and on the outdoor signage in front of the building. The Room is available for rent to the general public as well as to members of the RELATED ORG. They offer services including catering, food, bar, and cleaning. The room has full kitchen and bar facilities and offers a dance floor area in addition to table and chair set ups as specified by the renter. The organization has control over the employees and the operations of the Room, as well as the Open bar area in their meeting room.

The Form 990, Federal tax return, filed for the organization did not properly report income and expenses from the activities in connection with the bingo hall concessions and the Room rentals and bar income. The income from the concessions offered seven nights a week were reported in error on the RELATED ORG tax return for the period ending June 30, 20xx. The organization reported only rents on the tax return for the period ending June 30, 20xx. They reported rents and concessions on the tax return for the period ending June 30, 20xx. In both

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years, the income from the bar connected to the Room and the RELATED ORG meeting room was not reported on the organization's tax returns. It was determined that they controlled the bar operations by providing employees and management over the inventories. The RELATED ORG cannot engage in unrelated business income from non members without reporting that taxable income on Form 990-T.

There were no Forms 990-T filed by either the RELATED ORG or the organization.

**LAW:**

Section 501(c)(2) of the Internal Revenue Code ( the "Code") provides for the exemption from federal income tax of corporations organized for the exclusive purpose of holding title to property, collecting income there from, and turning over the entire amount thereof, less expenses to an organization which itself is exempt under this section. Rules similar to the rules of subparagraph (G) of paragraph (25) shall apply for purposes of this paragraph.

Under section 501(c)(25)(G) of the Code an organization shall not be treated as failing to be described in section 501(c) (2) by reason of the receipt of any otherwise disqualifying income which is incidentally derived from the holding of real property which does not exceed 10 percent of the organization's gross income for the taxable year.

Section 1.501(c) (2)-1(a) of the Income Tax Regulations (the "regulations") provides that since a corporation cannot be exempt under section 501(c) (2) if it engages in any business other than that of holding title to property and collecting income there from, it generally cannot have unrelated business taxable income as defined in section 512 other than unrelated business rental income described in section 514.

Section 511(a) of the Code imposes a tax on the unrelated business taxable income of organizations described in section 501(c) (2).

Section 512(b) (3) of the Code modifies the definition of unrelated trade or business by excepting all rents from real property.

Section 1.512(b)-1 of the regulations provides that whether a particular item of income falls within any of the modifications provided in section 512(b) shall be determined by all the facts and circumstances of each case.

Under section 1.512(b)-1(c) (2) of the regulations the term rents for purposes of section 512(b) includes all rents from real property. However, certain rents from, and certain deductions in connection with, debt-financed property (as defined in section 514(b)) shall be included in computing unrelated business taxable income.

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Section 1.512(b)-1(c)(5) of the regulations provides that payments for the use or occupancy of rooms and other space where services are also rendered to the occupant, such as for the use or occupancy of rooms or other quarters in hotels, boarding houses, or apartment houses furnishing hotel services, or in tourist camps or tourist homes, motor courts or motels or for the use or occupancy of space in parking lots, warehouses, or storage garages, does not constitute rent from real property. Generally, services are considered rendered to the occupant if they are primarily for his convenience and are other than usually or customarily rendered in connection with the rental of rooms or other space for occupancy only. The supplying of maid service, for example, constitutes such service; whereas the furnishing of heat and light, the cleaning of public entrances, exits, stairways and lobbies, the collection of trash, etc. are not considered as services rendered to the occupant.

Section 514(b)(1) of the Code defines debt-financed as any property which is held to produce income and with respect to which there is an acquisition indebtedness at any time during the taxable year, except that such term does not include property where substantially all of the use is related to the charitable, educational or other purpose of the organization under section 501.

Rev. Rul. 69-381, 1969-2 C.B. 113 held that income from the rental of offices to the general public did not preclude exemption from federal income tax under section 501(c)(2) of the Code where the title holding corporation did not render substantial services to the tenants other than the normal maintenance of the building and grounds. The general public tenants were not related in any way to the title holding company or the charitable organization for which it holds title.

Reg. 1.501(c)(2)-1(b) states that a corporation described in section 501(c)(2) cannot accumulate income and retain exemption, but it must turn over the entire amount of such income, less expenses, to an organization which is itself exempt under section 501(a).

Although neither the Code nor the Regulations specify the actual timing of remittance, an IRC 501(c)(2) organization should turn over its net income to its parent as soon as practicable, but at least annually.

#### GOVERNMENT'S POSITION:

Section 501(c)(2) of the Internal Revenue Code (the "Code") provides for the exemption from federal income tax of corporations organized for the exclusive purpose of holding title to property, collecting income there from, and turning over the entire amount thereof, less expenses to an organization which itself is exempt under this section.

The operation of the bingo hall concession stand and the services provided at the Room do not meet the exclusive purposes of holding title to property and collecting rents. These activities are

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under the control of the organization acting as the employer providing employees to provide services beyond those allowed as rental activity.

The rental of the bingo hall and the Room to the general public included other substantial services by offering concessions, bar, and food services for their convenience. The rental agreements were not available to determine if these services are separately stated in the rental fee charged. Therefore, the proper rental income cannot be determined. The services provided are not part of the rental activity and should be considered separate activities and subject to taxation.

The services provided income over % of the total gross income from the general public which does not meet the tax exempt purposes of a fraternal organization operated primarily for members and their charitable purposes. As a Section 501(c)(2) subsidiary organization, the organization's exempt purposes are to collect rents and support the RELATED ORGs exempt purposes.

The organization is required to turn over any excess accumulated amounts to them. They have not had any excess funds to turn over due to losses incurred in operating the hall .

The regulations provide that an organization cannot have unrelated business income other than income which is treated as unrelated because of the application of IRC 512(a)(3)(C); or debt-financed income which is treated as unrelated because of IRC 514; or certain interest, annuities, royalties, or rents which are treated as unrelated because of IRC 512(b)(3)(B)(ii) or (13); and certain rents from personal property leased with real property which are treated as unrelated because of IRC 512(b)(3)(B)(i) or because of failure to meet the "incidental amount" exception in IRC 512(b)(3)(A)(ii).

The rental income does meet the exception under Section 514 and would have been treated as debt financed income if the organization continued to meet Section 501(c)(2).

The income from the service activities do not meet any of the exceptions provided and are taxable. None of the income was treated as unrelated business income and no Form 990-T was filed.

As a result, we have determined that the organization no longer qualify for exemption under section 501(c)(2).

Therefore, we propose to revoke the organization's exempt status under section 501(c)(2) of the Internal Revenue Code effective July 1, 20xx.

**CONCLUSION:**

It is the government's position that the organization failed to operate properly to be

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recognized as exempt from federal income tax under 501(c)(2) of the Internal Revenue Code.

Accordingly, the organization's exempt status is revoked effective July 1, 20xx.

As a taxable entity the organization will be required to file Form 1120 returns for the tax periods after July 1, 20xx.