

**Internal Revenue Service
Appeals Office**

Date: August 6, 2008

Number: 201428019

Release Date: 7/11/2014

A
B
C

LEGEND:

A =

B =

C =

Certified Mail

Dear

This is a final adverse determination as to your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC). It is determined that you do not qualify as exempt from Federal income tax under IRC Section 501(c)(3) effective the date of this letter.

Our adverse determination was made for the following reason(s): Your primary activity and purpose since your inception has consisted of the operation of bingo games. Bingo does not, in and of itself, further an exempt purpose. You are a "feeder organization" within the meaning of I.R.C. § 502(a) which provides, in part, that such an organization shall not be exempt from taxation on the grounds that all of its profits are payable to one or more organizations exempt from taxation. Accordingly, you are not operated exclusively for exempt purposes as described in I.R.C. § 501(c)(3). See Treas. Reg. § 1.501(c)(3)-1(a).

Contributions to your organization are not deductible under Code section 170.

You are required to file Federal income tax returns on the form indicated above. You should file these return(s) within 30 days from the date of this letter, unless a request for an extension of time is granted. File the returns in accordance with their instructions, and do not send them to this office. Processing of income tax returns and assessment of any taxes due will not be delayed because you have filed a petition for declaratory judgment under Code section 7428.

If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, a petition to the United States Tax Court, the United States Court of Claims, or the district court of the United States for the District of Columbia must be filed

Department of the Treasury

Person to Contact:

Employee ID Number:

Tel:

Fax:

Refer Reply to:

In Re:

Form Required to be Filed:

Tax Period(s) Ended:

**Last Day to File a Petition with the
United States Tax Court:**

UIL: 501.03-01

within 90 days from the date this determination was mailed to you. Contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217.

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: 1114 Commerce St., Room 1004, MC 1005DAL, Dallas, TX 75242 (214) 413-6500

We will notify the appropriate State officials of this action, as required by Code section 6104(c). You should contact your state officials if you have any questions about how this determination may affect your state responsibilities and requirements.

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

Sincerely,

TEAM MANAGER



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
M/S 1112, P.O. BOX 12307
OGDEN, UT 84412

March 1, 2008

Taxpayer Identification number:

Form(s):

ORG
ADDRESS
UIL: 501.03-01

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 revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain 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.

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

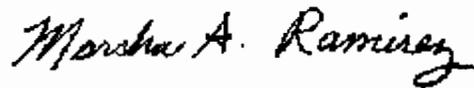
If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

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,



Marsha Ramirez
Director, EO Examinations

Enclosures:

Publication 892
Publication 3498
Form 4621-A, Report of Examination
Form 886-A, Explanation of Items
Form 6018, Consent to Proposed Action

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule number or exhibit 0001
Name of taxpayer ORG	Tax Identification Number	Year/Period ended December 31, 20XX

LEGEND

ORG = Organization name XX = Date XYZ = State motto = motto
CO-1, CO-2, CO-3 = 1st, 2nd & 3rd companies County = county

Primary Issue:

Whether the ORG tax exempt status under IRC Section 501(c)(3) should be revoked because:

- 1) the primary activity of the organization is motto; and
- 2) the organization does not perform any charitable or educational activities.

Alternate Issue:

Whether the ORG Form 990-T for the year under examination should have unrelated business taxable income recalculated and additional tax assessed.

Facts, Primary Issue:

This non profit organization was formed under the laws of the State of XYZ. The ruling date the IRS recognized exemption, under Section 501(c)(3) of the Internal Revenue Code, is 20XX-10. The organization applied to the State of XYZ for and was granted a certificate of authority under the XYZ Non-Profit Corporation Act, based on the exemption granted by the Service. Motto games are legal in XYZ as long as they are performed by exempt organizations.

The organization filed their application for exemption, Form 1023, in May of 20XX. They requested exemption based on the mission to raise funds for youth sports by primarily conducting motto games. They stated in the application that 'at this time it is not anticipated the organization will conduct any other activities but motto'. The primary activity of the organization continues to be motto games.

On October 12, 20XX the Service issued a determination letter recognizing ORG as an organization described in Section 501(c)(3) effective January 3, 20XX. The Service's determination letter also gave an advance ruling period of five years, ending December 31, 20XX.

The organization has filed the required returns, Forms 990 and 990T, for the year(s) in question. The return, Form 990, for the year under examination was received on October 10, 20XX, after the Service had requested it from the organization during a compliance check, but within the extension period. This return does indicate that motto is the primary activity that the organization participates in, and that they donate the majority of the profit earned to youth associations

During the examination the Revenue Agent requested the organization complete a schedule detailing all activities of the organization. The organization completed the schedule indicating that traditional motto and instant motto are the only activities performed.

The motto games are open to the general public.

This examination came about as part of a project examining organization's that had generated over \$ in gross revenue from motto activities and had not filed Form 990. The motto revenue information was received by the IRS from the CO-1 (CO-1).

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule number or exhibit 0001
Name of taxpayer ORG	Tax Identification Number	Year/Period ended December 31, 20XX

LEGEND

ORG = Organization name XX = Date XYZ = State motto = motto
CO-1, CO-2, CO-3 = 1st, 2nd & 3rd companies County = county

The CO-1 reported the following:

	Gross Revenue	Prizes Paid out	Charitable Contributions Paid Out	Net Motto Revenues
Traditional Motto			\$ -	
Instant Motto			\$ -	
Total Motto Revenues			\$ -	

ORG also stated that they also receive revenues from rental income and interest income. For the tax year ending December 31, 20XX the rental income totaled \$, and the interest income totaled \$.

The organization reported on Form 990 that they spent \$ to "provide financial support for CO-2. This Assoc. provides cash assistance to purchase equipment or improve facilities for youth organization of County." This same amount is report on Form 990-T as a charitable contributions deduction from the unrelated business income of instant motto. However, as indicated in the above table, this amount of charitable contributions was not reported to the CO-1. The revenue agent requested financial documentation to support the amount claimed on the return for donations given. The organization has failed to provided any verification of these charitable donations, and so the validity has not been verified.

Law, Primary Issue:

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.

Section 501(c)(3) of the Code provides exemption for corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the regulations states that in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will not be regarded as "operated exclusively" for one or more exempt purposes described in section 501(c)(3) of the Code if more than an insubstantial part of its activities is not in furtherance of a 501(c)(3) purpose.

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule number or exhibit 0001
Name of taxpayer ORG	Tax Identification Number	Year/Period ended December 31, 20XX

LEGEND

ORG = Organization name XX = Date XYZ = State motto = motto
CO-1, CO-2, CO-3 = 1st, 2nd & 3rd companies County = county

Section 1.501(c)(3)–1(d)(2) of the regulations provide that the term “charitable” is used in IRC 501(c)(3) in its generally accepted legal sense and includes relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of government; promotion of social welfare.

Help the Children, Inc v Commissioner (28 T.C. 1128, 1957 WL 1150) involved an organization whose exempt purpose was to acquire funds and financial assistance for the care and assistance of needy children and children’s institutions. The organization’s primary activity was the operation of motto games. Significant contributions were given to various individual doctors and charitable institutions.

The court stated that, “The record shows that one of the purposes for which petitioner was operated was to engage in commercial activities (motto games) for profit.” The organization has some other issues regarding the recipients of the contributions and revocation was upheld.

Piety, Inc v Commissioner (82 T.C. 193, 1984 WL 15530) involved an organization whose exempt purpose was to raise funds for the furtherance of charitable groups, religious groups, and non profit ambulance service groups. The organization’s primary activity was conducting motto games. The court’s opinion states that, “To qualify for exemption as an organization described in section 501(c)(3), petitioner (Piety, Inc) must be operated exclusively for exempt purposes. Petitioner contends it satisfies this requirement because it will contribute the profits of the motto games to exempt organizations. Respondent (Commissioner) alleges section 502(a) precludes petitioner from qualifying for exemption on that ground. *Respondent is correct.*” Emphasis added.

The court went on to analyze Piety, Inc. in regards to section 502. “Subject to the exceptions provided by section 502(b), section 502(a) prevents an organization which is operated for the primary purpose of carrying on a trade or business for profit from qualifying for exemption on the ground that its profits are payable to exempt organizations. Petitioner is operated for the primary purpose of carrying on a trade or business (motto games) for profit within the meaning of section 502(a). Section 502(a) therefore precludes petitioner from qualifying for exemption by merely supporting exempt organizations unless one of the exceptions in section 502(b) is applicable.”

The court also went out of its way to emphasize, “Petitioner may qualify for exemption only if it *directly* serves some exempt purpose.” Revocation was upheld.

South Community Association v Commissioner (T.C. Memo. 2005-285, 2005 WL 3434913) involved an organization whose exempt purpose was to make contributions to various charities for the purposes of starting educational programs, building a school, and transporting handicapped individuals to various schools. The organization funded its contributions almost entirely through its gaming operation. The gaming operation consisted of its sale of motto cards and instant pull-tab tickets.

The court commented that, “In order for petitioner (South Community Association) to prevail on the issue that we decide herein, we must find that petitioner was both organized and operated exclusively for

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule number or exhibit 0001
Name of taxpayer ORG	Tax Identification Number	Year/Period ended December 31, 20XX

LEGEND

ORG = Organization name XX = Date XYZ = State motto = motto
CO-1, CO-2, CO-3 = 1st, 2nd & 3rd companies County = county

one or more exempt purposes.” The court went on to conclude that, “The gaming operation was petitioner’s principal activity and was conducted by petitioner as a business for profit. Petitioner does not argue, nor do we find, that this activity was in furtherance of its exempt purpose. We therefore conclude that respondent properly revoked petitioner’s tax-exempt status...because petitioner was not operated exclusively for an exempt purpose. *While Congress allows certain organizations tax-exempt status for specific limited activities, petitioner attempts to retain tax-exempt status for activities that are outside of those permitted.*” Revocation was upheld.

Taxpayer’s Position, Primary Issue:

The organization’s protest letter explaining their position is attached hereto. Please see the attached.

Government’s Position, Primary Issue:

The statement in the protest letter from the organization, “The organization performs exactly the activities that were outlined in their application for exemption filed on Form 1023 in May 20XX” is recognized as a true statement, and the IRS is not arguing this fact. The position of the government is that exemption was granted erroneously and can not be permitted to continue as the organization does not qualify for exemption under Sections 501(c)(3) of the Code and 1.501(c)(3)-1 of the Regulations, as there is nothing inherently charitable about motto, and motto is the only activity of this organization beyond the activity of granting money to other charitable organization.

The organization claimed that they made charitable contributions of \$ however, an amount of \$ was reported to the State of XYZ. Given this fact along with the fact that the organization failed to provide any such substantiation of this claim, this amount is regarded as invalid.

Motto games, while specifically excepted from the definition of an unrelated trade or business, per Section of the Code, are still considered a trade or business. The fact that motto is a trade or business is undisputable as it has been established time and again in court cases. It is evident that the organization intended to and consistently did generate a profit from this activity. While XYZ state law may state that an organization qualifies for non-profit status as long as these profits are donated for charitable purposes; the use of these profits are not a factor in this determination at the federal level. The operation of a trade or business for profit can not be the primary purpose of an organization under Section 501(c)(3) of the Code.

All three of the court cases cited above determined that conducting motto games for profits constitutes a trade or business, and motto does not in and of its self further an exempt purpose.

The courts consistently upheld revocation of exempt status for organizations that had motto as their sole activity. In *Piety, Inc.* the court liberally interpreted section 502(a) to include any organization that conducts a trade or business and give the proceeds to charity. The court specifically stated that the organization needed to have a direct charitable activity. In *South Community Association*, the court ruled that the organization’s principal activity was conducting a business for profit. The court was

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule number or exhibit 0001
Name of taxpayer ORG	Tax Identification Number	Year/Period ended December 31, 20XX

LEGEND

ORG = Organization name XX = Date XYZ = State motto = motto
CO-1, CO-2, CO-3 = 1st, 2nd & 3rd companies County = county

aware that the organization's purpose was to make contributions to charity, but revocation was still upheld.

While XYZ state law is taken into consideration and noted, it remains subservient to Federal law. The Service realizes that this action creates a hardship on the organization with regards to operating in conflict with XYZ state law. This along with the fact that the Service erroneously granted exemption may be cause for relief relating to the effective date of the revocation under Section 7805(b), *Retroactivity of regulations*; however, this is not a reason to continue to allow exemption.

A rebuttal letter has been mailed to the organization in response to their protest letter. This is also attached hereto.

Conclusion, Primary Issue:

The Government concludes that ORG does not qualify for exemption from Federal income tax under IRC § 501(c)(3). As a result of this finding, the organization will be subject to the income tax imposed by IRC § 11 and is required to file Forms 1120 for all tax periods ending after January 1, 20XX.

Alternate Issue:

Whether the ORG Form 990-T for the year under examination should have unrelated business taxable income recalculated and additional tax assessed.

Facts, Alternate Issue:

The organization filed Form 990-T to report unrelated business income, on May 17, 20XX, significantly late and only after the IRS had contacted them and requested it during a compliance check. The organization's Form 990-T reported the following:

- Gross receipts or sales
- Expenses:
 - prizes
 - Salaries and wages
 - Taxes and licenses
 - Charitable Contributions
 - Rent
 - Total Expenses
- Net Income/Loss
- Tax Rate _____ %
- Total Tax Paid

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule number or exhibit 0001
Name of taxpayer ORG	Tax Identification Number	Year/Period ended December 31, 20XX

LEGEND

ORG = Organization name XX = Date XYZ = State motto = motto
CO-1, CO-2, CO-3 = 1st, 2nd & 3rd companies County = county

Some of these expenses they have deducted are large, unusual, and/or questionable. They claim they made charitable contributions from this income of \$, yet there was a net loss of \$. They reported \$ in rent paid for this activity, but on the Form 990 they claimed that the total amount of rent paid for all activities was \$.

If the Form 990-T tax liability was refigured the calculation would be as shown below, with the following corrections:

- Charitable contributions deduction disallowed, as it is not possible to distribute funds from a negative amount, and because the organization failed to substantiate the contributions.
- Rent expense deduction disallowed, as this expense would have been incurred regardless as to whether they performed instant motto or not.
- The gross revenue and prizes paid out based on amounts reported by the CO-1 (CO-1).

Gross Revenue	\$
Prizes Paid Out	\$
Net Revenues	\$
Less Directly Related Expense:	
Salaries and wages	\$
Taxes and licensing	\$
Specific Deduction	\$
UBTI	\$
Tax Rate	%
Tax Due	\$
Less Tax already paid	\$
Additional Tax Owed	\$

Law, Alternate Issue 1:

Section 511 of the Internal Revenue Code imposes a tax on the unrelated business income of every organization described in section 501(c).

Section 512 of the Internal Revenue Code states that the term "unrelated business taxable income" means the gross income derived by an organization from any unrelated trade or business regularly carried on by it, less the allowable deductions which are directly connected with the carrying on of such trade or business.

Section 513 of the Internal Revenue Code defines "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule number or exhibit 0001
Name of taxpayer ORG	Tax Identification Number	Year/Period ended December 31, 20XX

LEGEND

ORG = Organization name XX = Date XYZ = State motto = motto
CO-1, CO-2, CO-3 = 1st, 2nd & 3rd companies County = county

its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.

Section 513(f) of the Internal Revenue Code excludes from the term unrelated trade or business the conducting of motto games. Motto games means any game of motto – A) of a type in which usually the wagers are placed, the winners are determined, and the distribution of prizes is made in the presence of all persons placing wagers in such game, B) the conduction of which is not an activity ordinarily carried out on a commercial basis, and C) the conducting of which does not violate any State or local law.

Section 1.512(a)-1(c) of the regulations states that when facilities and personnel are used both to carry on exempt activities and to conduct unrelated trade or business activities, expenses shall be allocated between the two uses on a reasonable basis.

Julius M. Israel Lodge of B'nai B'rith No. 2113 v Commissioner – 98 F.3d 190. This case involved an organization exempt from income tax per section 501. The organization was assessed unrelated business income tax on their instant motto sales. The court found that instant motto games conducted by nonprofit, tax-exempt organization did not constitute “game of motto” within meaning of section 513(f) excluding motto games from unrelated business taxable income where instant motto game player did not place markers over randomly called numbers in attempt to form preselected pattern, but rather, purchased prepackaged card and removed pull-tabs to determine whether numbers on front of card matched numbers on back of card. The court ruled that the organization was liable for unrelated business income tax on their instant motto sales.

Taxpayer’s Position, Alternate Issue:

The organization has provided a letter of protest which is attached hereto. Please see the attached.

Government’s Position, Alternate Issue:

The organization filed Form 990-T reporting that they did in fact have paid employees. This is considered an admission to this fact, and the Form 990-T was signed under penalty of perjury. **It is considered unrealistic to assert that their paid employees became volunteers upon the conclusion of traditional motto games, to sell pull-tabs.** The burden of proof would be on the taxpayer to clearly substantiate this claim. Adequate substantiation has not been provided to establish this assertion.

The organization’s instant motto games constitute an unrelated trade or business as described in section 513, and as such, is liable for the unrelated business tax per section 511. The only direct expense that was identified was the prizes paid to instant motto winners. The wages and taxes are accepted as previously reported. Rent and charitable contributions are to be disallowed as they have been determined to be inaccurate.

Form 886-A (Rev. January 1994)	EXPLANATION OF ITEMS	Schedule number or exhibit 0001
Name of taxpayer ORG	Tax Identification Number	Year/Period ended December 31, 20XX

LEGEND

ORG = Organization name XX = Date XYZ = State motto = motto
CO-1, CO-2, CO-3 = 1st, 2nd & 3rd companies County = county

Forms 990-T for all subsequent years after this year under examination should be amended to reflect correct and allowable deductions. These amended returns should be submitted to the appropriate service center for processing.

A rebuttal letter has been mailed to the organization in response to their protest letter. This is also attached hereto.

Conclusion, Alternate Issue:

The Government concludes that ORG is liable for the additional unrelated business income tax of \$ in total for the period beginning January 1, 20XX and ending December 31, 20XX. The organization should file or amend Forms 990-T for periods January 1, 20XX forward.