



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
TEGE EO Examinations Mail Stop 4920 DAL
1100 Commerce St.
Dallas, Texas 75242

Date: December 27, 2016

Taxpayer Identification Number:

Person to Contact:

Employee Identification Number:

Employee Telephone Number:

Number: **201717045**
Release Date: 4/28/2017

UIL: 501.06-00

CERTIFIED MAIL – RETURN RECEIPT

Dear _____ :

This is a final adverse determination regarding your exempt status under section 501(c)(6) of the Internal Revenue Code. You are no longer exempt under section 501(a) of the Code for the year ending December 31, 20XX.

The revocation of your exempt status was made for the following reason(s):

You fail to meet the requirements set forth in Section 1.501(c)(6)-1 of the Regulations to be exempt under IRC 501(c)(6) because you provide advertising services to a limited number of dealers. You are performing services for your members by advertising for automobiles sold by your members. You are not engaging in activities to improve business conditions in the automotive industry as a whole. Therefore, you are not entitled to exemption from Federal income tax as a business league under IRC 501(c)(6).

You are required to file an income tax return on Form 1120. This return should be filed with the appropriate Service Center for the tax year ending December 31, 20XX in accordance with the instructions of the return.

Processing of income tax returns and assessments of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Internal Revenue Code.

If you decide to contest this determination under the declaratory judgment provisions of section 7428 of the Code, a petition to the United States Tax Court, the United States Claims Court, or the

district court of the United States for the District of Columbia must be filed before the 91st Day after the date this determination was mailed to you. Please contact the clerk of the appropriate court for rules regarding filing petitions for declaratory judgments by referring to the enclosed Publication 892. You may write to the United States Tax Court at the following address:

United States Tax Court
400 Second Street, NW
Washington, DC 20217

You also have the right to contact the Office of the Taxpayer Advocate. The Taxpayer Advocate Service (TAS) is an independent organization within the IRS that can help protect your taxpayer rights. TAS can offer you help if your tax problem is causing a hardship, or you've tried but haven't been able to resolve your problem with the IRS. If you qualify for TAS assistance, which is always free, TAS will do everything possible to help you. Visit taxpayeradvocate.irs.gov or call 1-877-777-4778. If you prefer, you may contact your local Taxpayer Advocate at:

Internal Revenue Service
Office of the Taxpayer Advocate

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

Sincerely,

Mary A. Epps
Acting Director, EO Examinations

Enclosures:
Publication 892



Department of the Treasury
Internal Revenue Service
Tax Exempt and Government Entities
Exempt Organizations Examinations

Date:
July 22, 2016
Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Manager's Name/ID Number:

Manager's Contact Number:

Response due date:

UIL: 501.06-00

Certified Mail – Return Receipt Requested

Dear _____ :

Why you are receiving this letter

We propose to revoke your status as an organization described in section 501(c)(6) of the Internal Revenue Code (Code). Enclosed is our report of examination explaining the proposed action.

What you need to do if you agree

If you agree with our proposal, please sign the enclosed Form 6018, *Consent to Proposed Action – Section 7428*, and return it to the contact person at the address listed above (unless you have already provided us a signed Form 6018). We'll issue a final revocation letter determining that you aren't an organization described in section 501(c)(6).

If we don't hear from you

If you don't respond to this proposal within 30 calendar days from the date of this letter, we'll issue a final revocation letter. Failing to respond to this proposal will adversely impact your legal standing to seek a declaratory judgment because you failed to exhaust your administrative remedies.

Effect of revocation status

If you receive a final revocation letter, you'll be required to file federal income tax returns for the tax year(s) shown above as well as for subsequent tax years.

What you need to do if you disagree with the proposed revocation

If you disagree with our proposed revocation, you may request a meeting or telephone conference with the supervisor of the IRS contact identified in the heading of this letter. You also

may file a protest with the IRS Appeals office by submitting a written request to the contact person at the address listed above within 30 calendar days from the date of this letter. The Appeals office is independent of the Exempt Organizations division and resolves most disputes informally.

For your protest to be valid, it must contain certain specific information including a statement of the facts, the applicable law, and arguments in support of your position. For specific information needed for a valid protest, please refer to page one of the enclosed Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*, and page six of the enclosed Publication 3498, *The Examination Process*. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process. Please note that Fast Track Mediation referred to in Publication 3498 generally doesn't apply after we issue this letter.

You also may request that we refer this matter for technical advice as explained in Publication 892. Please contact the individual identified on the first page of this letter if you are considering requesting technical advice. If we issue a determination letter to you based on a technical advice memorandum issued by the Exempt Organizations Rulings and Agreements office, no further IRS administrative appeal will be available to you.

Contacting the Taxpayer Advocate Office is a taxpayer right

You have the right to contact the office of the Taxpayer Advocate. Their assistance isn't a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate can't reverse a legally correct tax determination or extend the time you have (fixed by law) to file a petition in a United States court. They can, however, see that a tax matter that hasn't 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
Office of the Taxpayer Advocate

For additional information

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,

Margaret Von Lienen
Director, EO Examinations

Enclosures:
Report of Examination
Form 6018
Publication 892
Publication 3498

Form 886-A (in lieu of)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer	Tax Identification Number	Year/Period ended 12/31/20XX

ISSUES:

1. Can _____ (the "Association"), providing advertising services to its members, claim to be a business league under Section 501(c)(6) of Internal Revenue Code (the "Code")?
2. Can the Association continue to report its financial information on a cash basis for 20XX and after?

FACTS:

Background

The Association incorporated on March 10, 20XX, and stated its purpose as "to engage in any lawful act or activity, other than credit union business."

The Association completed a Form 1024, *Application for Recognition of Exemption Under Section 501(a)*, on June 15, 20XX, applying for exempt status under Section 501(c)(6) of the Code. The Association described its activities on its Form 1024 as follows:

The Organization's activities are to promote and advertise products and services retailed by each member. The venues for promotion will be television XX%, radio XX% and newspaper X%. Television advertising agency will be retailed [sic] to produce and market commercials [sic] relating to the organization's members products and services. The same will be done for the two other venues (radio and newspaper). The promoters and advertising agencies will be evaluated as to their effectiveness and the public awareness of the member's product and services.

In the bylaws, the Association stated its purposes as follows:

*... **Primary Purpose.** ... to advertise and promote the products and services of dealers who are members of this corporation.*

*... **General Purposes** ...*

(a) To foster and promote retail trade and commerce in connection with the products and services of the members, and to protect the same from unjust and unlawful exactions and impositions.

(b) To foster and promote the interest of those persons, firms and corporations engaged in the retailing of _____ in the _____ DMA (Designated Market Area-a television advertising market as defined by Nielsen

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Media Research, Inc.), and such other areas as may be designated by the Board of Directors and

(c) To conduct and operate means and places of disseminating information relative to the use of motor vehicles and to promote the sale of motor vehicles, and for such purposes to establish, conduct and manage advertising and promotional campaigns, exhibitions, display tests, trials, and demonstrations.

(d) To promote the establishment and maintenance of a high standard of business ethics by members of the corporation and by all other automobile dealers, and to discourage the use of false or misleading advertising or any other business practice, which may be detrimental to the public and the retail automobile industry.

The bylaws limited its membership as follows:

... those persons and legal entities who (1) are actively engaged in the retailing of motor vehicles as duly authorized holders of Dealer Sales and Service Agreements for vehicles ("Dealers"), (2) are doing business in or about that geographical area as delineated by as the DMA, and such other areas as may be designated by the Board of Directors and , and (3) are participating in a program and under the term of the program and contributing funds to that program at the rate established by the Board of Directors. Applications for membership shall be submitted to the Board of Directors, and an affirmative vote of a majority of the Directors shall be required for election to membership.

On October 1, 20XX, we asked for clarification on some items stated in the Form 1024, and informed the Association that "Currently, it does not appear that your organization will meet the standards of section 501(c)(6). Please submit any and all information that you would like us to consider ..." We did not receive a response.

On November 20, 20XX, we notified the Association that we could not review the application because we didn't receive the requested information. We allowed the Association to provide the requested information within 90 days, to re-activate the application process. We have no records of the Association providing any of the requested information.

Activities

We audited the Form 990, *Return of Organization Exempt From Income Tax*, for the year ended December 31, 20XX. The Association provided the following statement in regards to its activities:

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The _____ is formed with 1 or more dealers within a DMA (designated market area). The dealer(s) agree to contribute a certain percentage of each vehicle sale that goes into the _____ budget. The budget is then invested for marketing & advertising purposes to generate qualified customer traffic to the contributing dealerships. By combining forces, it allows the dealers to afford expensive advertising costs such as TV, digital and experiential executions. The advertising agency handles all this for the dealer group and reports back on a regular basis (in-person meetings, conference calls, etc).

For the _____, all X dealers in the DMA contribute to this budget at X.X% of each new vehicle sale. At the beginning of each year, an estimated budget is established and an advertising plan is put together for the calendar year. The agency develops a recommendation and presents this to the group, upon approval the agency executes the plan (media, production, experiential, etc.). As each month passes by, actual sales and expenditure information gets updated and tracked (i.e. Jan gets actualized in early Feb). It's the agency's responsibility to keep accurate records of this in order to gage if the earlier estimates are holding true. The agency will then make appropriate changes to the overall advertising plan based on the actual information if necessary. This process continues through the entire year.

Members of the Association held regular meetings and communicated with each other throughout the year to discuss and decide when and how to advertise their products. However, the Association did not provide minutes of these meetings to us.

_____, the Association's representative, stated that the Association did not have a bank account. _____ withholds X.X percent of funds for advertising allowance. Dealers put out advertisements in their local area and _____ pays advertising expenses directly to the vendors. _____ pool their resources to do group advertisements. Although these dealers conducted their advertising activities through the Association, it has no monetary transactions.

_____ keeps track of funds it withholds, and expenses it pays. _____ sends monthly reports to the Association, showing available funds and expenses paid. _____ monthly reports for 20XX indicate that _____ held \$X,XXX,XXX.XX; paid \$X,XXX,XXX.XX in expenses; and returned \$XXX,XXX.XX to dealer-members. _____ returned funds to dealer-members throughout the year, averaging \$XX,XXX a month. _____ indicated the Association's account balances as \$XX,XXX.XX at the beginning, and \$XXX,XXX.XX at the end of 20XX.

Returns Filed

Our records indicate that the Association filed Forms 990, and Forms 990-T, *Exempt Organization Business Income Tax Return*, since 20XX. The Association reported zero revenue and expense on all Forms 990-T.

Form 886-A (in lieu of)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
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The Association filed Forms 990 based on _____ monthly reports, using cash method. Prior to 20XX, the Association only reported the total amount of expenses paid as both revenue and expenses, and zero amounts for balance sheet items. Beginning in 20XX, the Association changed its reporting style, even though it continues to check the box for cash accounting method. The Association reported the total amount withheld as revenue, resulting in net gain or loss for the year, as shown in the table below:

Description	20XX	20XX	20XX	20XX
Membership dues (n1)	x,xxx,xxx	x,xxx,xxx	x,xxx,xxx	x,xxx,xxx
Expenses				
Accounting				x,xxx
Advertising & promotion	x,xxx,xxx	x,xxx,xxx	x,xxx,xxx	x,xxx,xxx
Administration fees	xx,xxx	xxx,xxx	xxx,xxx	xxx,xxx
Conference, conventions & meetings				x,xxx
Insurance				x,xxx
Travel				x,xxx
Total Expenses	x,xxx,xxx	x,xxx,xxx	x,xxx,xxx	x,xxx,xxx
Net Income	x	(xx,xxx)	xxx,xxx	xx,xxx
Accounts Receivable	(n2) x	xx,xxx	xxx,xxx	xxx,xxx

n1 Total less

n2 This amount was \$xxx,xxx on 20xx return.

In retrospect, _____ indicated the change in reporting since 20XX was incorrect, because *“There has never been nor there ever will be any profits relating to the above mention advertising expenditures. _____ controls the funds (bank accounts) and the disbursements (checks).”*

LAW:

Issue 1: Exemption status

Section 501(c)(6) of the Code provides for the exemption of business leagues, chambers of commerce, real estate boards, boards of trade, and professional football leagues, which are not organized for profit and no part of the net earnings inure to the benefit of any private shareholder or individual.

Section 1.501(c)(6)-1 of Treasury Regulations (the “Regulations”) describes a business league as an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board

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of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. An organization, whose purpose is to engage in a regular business of a kind ordinarily carried on for profit, even though the business is conducted on a cooperative basis or produces only sufficient income to be self-sustaining, is not a business league.

Revenue Ruling 67-77, describe a situation similar to the Association. It states, "An organization composed of dealers in a certain make of automobile in a designated area is organized and operated for the primary purpose of financing general advertising campaigns to promote, with funds contributed by dealer members, the sale of that make of automobile. *Held*, the organization is performing particular services for its members and is not entitled to exemption from Federal income tax as a business league under section 501(c)(6) of the Code of 1954."

In the *National Muffler Dealers Association, Inc., v. United States* (99 S.Ct. 1304, 1310+, U.S.N.Y.), a trade organization for muffler dealers sued for an income tax refund, claiming the "business league" exemption. The District Court rendered judgment for the Government and the United States Court of Appeals for the Second Circuit, 565 F.2d 845, affirmed. On certiorari, the Supreme Court, Mr. Justice Blackmun, held that, because the association had confined its membership to dealers franchised by one company and its activities to the muffler business, it was not a "business league."

Issue 2: Accounting Method and Tax on Net Income

Section 11 of the Code imposes income tax on net earnings of corporations.

Section 448(a) of the Code allows a corporation to use cash basis of account, if it meets one of the exceptions. The applicable exception here is Section 448(b)(3): Entities with gross receipts of not more than \$5,000,000.

TAXPAYER'S POSITION:

states that the Association will agree with our proposal to deny its exempt status. However, the Association should not be paying taxes on funds it never received, and had no control over.

GOVERNMENT'S POSITION

Issue 1: Exemption status

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The Association fails to meet the requirements set forth in Section 1.501(c)(6)-1 of the Regulations to be exempt under Section 501(c)(6) of the Code, because it provides advertising services to a limited number of dealers. The following facts support this statement:

- The Association's membership is limited to dealers in the geographical area outlined by as the DMA.
- Members participate in a under the term of the program and contribute funds at rates established by .
- The Association's activities directly benefit its members when it promotes and advertises members' products and services.

The Association's activity is similar to situations stated in Revenue Ruling 67-77, and the court case, *National Muffler Dealers Association, Inc., v. United States*. In the Revenue Ruling, the organization was not exempt under Section 501(c)(6) of the Code because it was providing specific services to its members. In the court case, the organization was providing its services to muffler dealers of specific manufacturer. Three different courts supported our position that the organization should not be a exempt under Section 501(c)(6) of the Code.

The Association can't claim that it qualifies as a business league under Section 501(c)(6) of the Code, and we should deny its exempt status effective January 1, 20XX.

Issue 2: Accounting Method and Tax on Net Income

The Association meets an exception to use cash accounting method. The Association used cash method since its formation until 20XX.

We agree that reporting financial activities on cash basis is proper because the Association has no fiscal control of funds. According to the records we reviewed, has control of the following financial matters:

- How much to withhold in advance, based upon agreements with dealer-members
- Adjustments to make, based upon actual delivery of automobiles makes to dealers
- Funds to return to dealer-members and which dealer-member to return funds to
- Expense disbursements

Although the Association has excess funds, the Association can only use them in manners agreed upon between and dealer-members.

CONCLUSION

Form 886-A (in lieu of)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer	Tax Identification Number	Year/Period ended 12/31/20XX

Issue 1: Exemption status

The Association is performing services for its members by advertising for automobiles sold by its members. The Association isn't engaging in activities to improve business conditions in the automotive industry as a whole. Therefore, it is not entitled to exemption from Federal income tax as a business league under Section 501(c)(6) of the Code. We deny the exempt status of the Association effective as of January 1, 20XX.

Issue 2: Accounting Method and Tax on Net Income

The Association is required to file Forms 1120, *U.S. Corporation Income Tax Return*, for 20XX and all subsequent tax years.

The Association may use cash accounting method to report its financial information for these years.