

Internal Revenue Service

Appeals Office
4330 Watt Avenue SA 7890
Sacramento, CA 95821-7012

Release Number: **201722029**

Release Number: 6/2/2017

Date: March 7, 2017

Department of the Treasury

Employer Identification Number:

Person to Contact:

Employee ID Number:

Tel:

Fax:

Tax Period Ended:

05/31/2013

UIL: 0501 .03-00

Certified Mail

Dear ,

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (the "Code"). It is determined that you do not qualify as exempt from Federal income tax under section 501(c)(3) of the Code effective June 1, 20

The revocation of your exempt status was made for the following reasons:

- Your primary activity was the regular operation of bingo and pull-tab games. The regular operation of bingo and pull-tab games does not, in itself, further tax-exempt purposes. You have not demonstrated that you operated exclusively for exempt purposes as described in section 501(c)(3) of the Code.
- You operated for the primary purpose of carrying on a trade or business for profit and all of your profits were payable to one or more organizations exempt from taxation under section 501 of the Code. We hereby determined that you are a feeder organization not exempt from taxation as described in section 502(a) of the Code.
- Treas. Reg. section 1.501(c)(3)-1(d)(ii) provides that an organization is not operated exclusively for exempt purposes unless it serves a public rather than a private interest. We hereby determined that you operated for the benefit of private interests of a private individual.

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

You are required to file Federal income tax returns on Forms 1120. File your return with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit www.irs.gov.

If you were a private foundation as of the effective date of the adverse determination, you are considered to be taxable private foundation until you terminate your private foundation status under section 507 of the Code. In addition to your income tax return, you must also continue to file Form 990-PF by the 15th Day of the fifth month after the end of your annual accounting period.

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 Code.

We will make this letter and the proposed adverse determination letter available for public inspection under Code section 6110 after deleting certain identifying information. We have provided to you, in a separate mailing, Notice 437, *Notice of Intention to Disclose*. Please review the Notice 437 and the documents attached that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437.

If you decide to contest this determination, you may file an action for declaratory judgment under the provisions of section 7428 of the Code in one of the following three venues: 1) United States Tax Court, 2) the United States Court of Federal Claims, or 3) the United States District Court for the District of Columbia. A petition or complaint in one of these three courts must be filed within 90 days from the date this determination letter was mailed to you. Please 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. See also Publication 892.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate 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 tax matters that may not have been resolved through normal channels get prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit www.irs.gov/advocate for more information.

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

Sincerely Yours,

Appeals Team Manager

Enclosure: Publication 892 and/or 556

cc:



Department of the Treasury
Internal Revenue Service
Tax Exempt and Government Entities Division
1100 Commerce Street, MC 4900 DAL
Dallas, TX 75242

Date: 12/14/15

Taxpayer Identification Number:

Form:

990

Tax year(s) ended:

May 31, 20

Person to contact / ID number:

Contact numbers:

Phone Number:

Fax Number:

Manager's name / ID number:

Manager's contact number:

Phone Number:

Response due date:

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)(3) 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)(3).

After we issue the final revocation letter, we'll announce that your organization is no longer eligible for contributions deductible under section 170 of the Code.

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 (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer	Tax Identification Number	Year/Period ended May 31, 20

Issues

1. Should tax-exempt status under Internal Revenue Code section 501(c)(3) be revoked because operation of a gaming hall is the organization's primary activity, in violation of Treasury Regulation section 1.501(c)(3)-1(c)(1)?
2. Should the organization's tax-exempt status be revoked because it has a more than insubstantial non-exempt purpose of providing private benefit to the gaming hall landlord in violation of Treasury Regulation 1.501(c)(3)-1(d)(1)(ii)?

Facts

Background

, EIN , is exempt from Federal income tax under Internal Revenue Code (IRC) section 501(c)(3) and is recognized as a public charity under IRC section 509(a)(2). The organization was incorporated in the State of in June 20 and was recognized as exempt from tax by the IRS effective October 20 () is the Foundation's founder and president.

The initial audit interview was conducted with and , CPA and representative, on December 2, 20 , CPA, also served as a representative during the audit. The year currently under audit is the year ending May 31, 20 . The stated that activities in subsequent years were not different in any material way, except that some costs may have changed slightly. IRS records show that the due date for the Form 990 for the year ending May 31, 20 was extended by the taxpayer to April 15, 20 . The 20 Form 990 was received by examining agent during the audit on August 27, 20 .

The purpose of as stated in the organization's bylaws is:
...to provide for the common unity and welfare of all local non-profit charities, their dependents and heirs, and to promote the social welfare of their communities, the County of State of

In the primary year under audit, conducted two activities to achieve this purpose.

These activities were:

- 1) Awarding grants to County organizations
- 2) Conducting gaming to generate income

is the founder and president of three entities that all engaged in these two activities at Bingo Hall. According to the Bingo Hall website, these three organizations are the only organizations that operate gaming in that location. All three are tax-exempt under IRC section 501(c)(3). IRS records show the three entities with their effective dates of exemption are:

- o October 20
- o Foundation June 20
- o Foundation October 20

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS		Schedule number or exhibit
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- board members were:
- o president (also president of the two related organizations)
 - o secretary/treasurer
 - o director
 - o director (also a director of Collegiate Foundation)
 - o director

three most recent filed Forms 990 show the following:

3-year Form 990 comparison			
year ending	May 20	May 20	May 20
other contributions	\$	\$	\$
gaming gross revenue	\$	\$	\$
prizes	(\$)	(\$)	(\$)
rent	(\$)	(\$)	(\$)
other gaming expense	(\$)	(\$)	(\$)
payments to deli	(\$)	(\$)	(\$)
gaming net revenue	\$	\$	\$
total net revenue	\$	\$	\$
grants	\$	\$	\$
salaries	\$	\$	\$
accounting	\$	\$	\$
other expenses	\$	\$	\$
total expense	\$	\$	\$
net income	\$	\$	\$

Many of these items are discussed further in this report.

- o "Other contributions" were typically donations from winning players at the bingo hall
- o Rent was for the gaming hall and was paid to based on a per-session fee
- o "Payments to deli" were payments to the deli located in the hall for: food prizes awarded to players, complimentary drinks for players, and janitorial service
- o "Salaries" was compensation paid the bingo manager at each session and was paid out of "other contributions"
- o Accounting fees were primarily monthly payments to the bookkeeper

As discussed in this report, the three organizations started by were closely related. They shared the same president, they shared Bingo, they shared bingo workers, they used the same vendors, and they made contributions to each other. The same activity was conducted on a daily basis under one of three organizations' names. For this reason, it is more descriptive of the organizations' activities, to review the finances of the three organizations on an aggregated basis. The aggregate finances taken from the three most recently filed Forms 990 are as follows:

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS		Schedule number or exhibit
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aggregate 3-year Form 990 comparison			
year ending	May 20	May 20	May 20
contributions from related orgs	\$	\$	\$
other contributions	\$	\$	\$
gaming gross revenue	\$	\$	\$
prizes	(\$)	(\$)	(\$)
rent (father of founder)	(\$)	(\$)	(\$)
other gaming expenses	(\$)	(\$)	(\$)
payments to deli (brother of founder)	(\$)	(\$)	(\$)
gaming net revenue	\$	\$	\$
income	\$	\$	\$
scholarships to workers	\$	\$	\$
contributions to related orgs	\$	\$	\$
grants	\$	\$	\$
salaries	\$	\$	\$
accounting	\$	\$	\$
other expenses	\$	\$	\$
expense	\$	\$	\$
net income	\$	(\$)	\$

Charitable activities

Planned grant program

application for exemption, Form 1023; stated that the anticipated activities would be making grant distributions to nonprofit organizations for various community service activities such as youth sports, youth education, and youth programs which encourage sobriety, education, public safety, and the social welfare of residents of County. Grant applications would be distributed to the general public. The board would review completed applications and would approve grants based on the size of the funding request, the need and ability of the requesting party, and the benefit to the community.

The bylaws, signed in June 20 by then-Secretary, specify that there would be a Scholarship Committee of two to three board members. This committee would screen the applications and recommend applicants for scholarships, maintain policies and procedures for selection, and maintain records of award recipients. [Note: Before exemption was granted, the Determinations Specialist requested that brother, be removed from the board and replaced with an unrelated individual.]

Anticipated expenses were % of bingo income for prizes and % for overhead. The taxpayer stated, "Out of [the %], the remaining balance will be distributed to charities under the Applicant's Grant Application program." In response to follow-up questions from the Determinations Specialist, the applicant

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS		Schedule number or exhibit
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revised their expected charitable expenses to be % of bingo income after payment of bingo prizes. The applicant qualified the statement saying there is no budget history on which to base predictions.

Actual grant program

grant guidelines are available to the public on the Bingo website. The website reads (with no correction to text), "Bingo consists of 3 non-profit organizations, Foundation and Foundation both offer grants and scholarships, and Foundation offers grants." A program overview says that all three support County programs directed toward education, child and youth programs, and human and social services. The website proclaims: "% of profit goes to charity!" The current grant guidelines include a general rule that prefers to award grants to 501(c)(3) organizations that have been endorsed by the community as shown by community participation.

stated that board meetings were held quarterly to review grant applications. When requested to provide copies of meeting minutes, supplied documents titled "Action of the board of directors in lieu of— annual meeting or quarterly grant recipient meetings." stated that he reviewed all applications himself, confirmed that the criteria were met, and summarized and organized the applicant list for approval by the board. Upon approval, he created the "in lieu of meeting" document. The audit showed that only one grant applicant was not awarded. stated that applicants are almost never denied as long as they meet the minimum criteria and that the omission was likely a typo.

In the primary year under audit, the organization gave away a total of \$. \$ of this, or % was to the other two organizations playing at Bingo. No applications were made by these organizations. also said that bingo could have big losses, so they had to maintain a reserve of funds and couldn't give too much money in grants. At the end of the primary year under audit, the organization reported having \$ In liquid assets.

The following grants were awarded in the primary year under audit.

date	organization/check payable to	amount	FBO	relationship
Jul-		\$		potential child of volunteer
Jul-		\$		
Jul-		\$		potential child of volunteer
Jul-		\$		potential child of volunteer
Aug-		\$		volunteer
Nov-		\$		
Nov-		\$		related entity
Feb-		\$		related entity
Feb-		\$		
Feb-		\$		
May-		\$		
May-		\$		
		\$		

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
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Some grants were notated that they were "for the benefit of" or FBO a specified individual. Some FBOs could be matched with volunteer names, such as in the case of volunteer and grants for the benefit of

categories of giving		
related entities	\$	%
volunteer-related	\$	%
all others	\$	%
	\$	

Gaming activities

Gaming

stated that he started the organization "because he saw a need." He had experience with bingo, and when the opportunity to run gaming for charity arose, he thought he could be "more successful" than the predecessor. The Form 1023 application for exemption filed by the organization stated that revenue would be generated from operating a weekly bingo session.

In the primary year under audit, ran six-hour gaming sessions at Bingo three days per week. The current cost to play ranges from \$ - \$ depending on the number of games included and whether play is on paper or electronic. Additional packs of paper games can be bought for \$ each as can pull-tabs for \$ each. Bingo was advertised to the public in taxi cabs and in the newspaper. The general ledger shows over \$ paid for these advertisements in the primary year under audit.

Games played included bingo, pull-tabs, and flash. Bingo and pull-tabs conform to the traditional meaning of the games. Flash is a combination of bingo and pull-tabs. It is played with pull-tab-like cards. Players tear off a cardboard flap and win based on the images revealed, like pull-tabs, or by marking off random numbers called, like bingo. Of the five sample flash cards provided, an average of % of the payout went to bingo-like winners and % went to pull-tab-like winners.

Bingo hall is a large, square foot structure. About square feet is used by the Deli to prepare and sell food and to provide drinks to players. The bingo hall has a large playing room which estimated could seat players and a smoking room which could seat another players. There was also a small stage for the caller with a podium and equipment for selecting balls, a long counter with Plexiglas displays for various pull-tabs and flash games, bingo display boards on each of the four walls, and three free-standing pull-tab dispensing machines. The building also includes an entry way, offices, and storage.

Relationship with bingo hall landlord

In the application for exemption, the taxpayer stated that that they were "currently negotiating a lease of a facility for one session per week" at . Specifically, the Form 1023 application states:

- o Applicant is currently negotiating a lease
- o Applicant is not related to landlord
- o Negotiations are at an arms-length transaction

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
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Upon follow-up questioning by the Determinations Specialist, clarified that the bingo hall, Bingo, was owned by and that the general managing partner of this entity was , a relative of . During the audit, further clarified that is his father. The taxpayer stated that they chose Bingo because the hall had availability for new tenants.

is a limited liability company with the following members in 19 :

- o
- o
- o
- o
- o

The purpose of the company was to engage in any lawful act or activity for which a limited liability company may be organized under the Limited Liability Company Act. is the company's general manager. All member companies contributed resources to the company with a total value of \$

In 20 , the members executed an amendment which transferred and assigned all of their rights as members in to the and made the the sole member of

The I was created in 19 by and his wife. Per the Trust agreement, upon the death of the first Trustor, the Trust would be divided into a marital trust, a family trust, and a survivor's trust. Exhibit B to the Trust directs the Trustee to separate out all applicable amounts in order to take advantage of favorable federal tax treatment. has passed away. Compliance with the original trust document has resulted in the following relevant trusts:

- o (aka)
- o
- o (aka)
- o
- o

Per the Trust agreement, receives all net income from the on a quarterly or more frequent basis. The trustee has the power to amend or revoke the Survivor's Trust and to distribute all income. He is the sole beneficiary of the Marital and Family Trusts only after the Survivor's Trust is spent down.

Bingo rent

During the determinations process, stated that the rent amount was based on a local industry survey. In , the application states, there was one other bingo hall aside from Bingo. The industry survey showed that the bingo halls charged \$ - \$ per session. provided non-contemporaneous documentation of the fair market value of bingo hall rentals which show per-session lease amounts ranging from \$ to \$. Publically available gaming reports filed with the City of

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

for two local non-profits show per-session rents range from \$ to \$. The initial lease agreement gradually increased rent from \$0 per session in September 20 to \$ in March 20

provided a copy of the license agreement between , dba , and . The agreement states, "For and in consideration of the License and the Licensee's covenant to pay Rent and to perform the covenants and conditions set forth in this License, Licensors hereby licenses to Licensee, and the Licensee hereby accepts from the Licensors the Premises, as herein defined, in accordance with the terms...set forth below." "The premises" is defined as the parking area and portions of building excluding the kitchen and food concession area but including the tables, chairs, and bingo equipment. The license to conduct bingo on Tuesday, Wednesday, and Thursday from 5 to 11pm commenced in 20 and terminates in 20 . A rental fee will be paid in advance per bingo session, whether or not the session is held. Base fee will be:

- o \$ for January 20 through July 20
- o \$ for August 20 through December 20
- o \$ for January 20 through June 20
- o \$ for July 20 through December 20

Rental fees for July 20 through June 20 are not indicated.

The license agreement is signed by on behalf of and on behalf of

In the primary year under audit, total rent expense was \$

date	# sessions	rate	total	match lease agreement?
6/30/20	13	\$	\$	yes
7/31/20	12	\$	\$	no
8/31/20	not specified	not specified	\$	
9/1/20	12	\$	\$	no
10/1/20	13	\$	\$	no
11/30/20	13	\$	\$	no
12/1/20	12	\$	\$	no
1/1/20	14	\$	\$	yes
2/28/20	12	\$	\$	yes
3/1/20	13	\$	\$	yes
4/1/20	12	\$	\$	yes
5/31/20	15	\$	\$	no

was owned by . The lease agreement for Bingo specifies that the Licensors will operate or contract with a third party to operate a snack bar within the food concession area during Licensee's bingo sessions. The agreement specifies that the organization will provide at least two ten-minute breaks to allow customers an opportunity to buy concessions and that the organization will pay a two-dollar-per-player-fee to the Deli to cover janitorial costs. The agreement also states that the Deli Operator will give four dinner specials to the organization to use as a promotional giveaway during the bingo session.

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS		Schedule number or exhibit
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stated that the deli was handled by the Bingo landlord. He also stated that the two-dollar-per-player fee was to cover complementary soda and coffee for players. There was no contract between the deli operator and

Weekly invoices from Deli submitted to reflect charges for each of the three sessions held that week. The charges for each session are broken down into 1) player fee (\$ per player to cover complementary beverages), 2) janitorial fee (\$ per session), and 3) food. Invoice amounts for food vary from \$ to \$ per session. These charges are for "player's reward fees" earned by customers and cashed in for food at the Deli. Payments to Deli were recorded in the General Ledger as "Hospitality." Total hospitality charges for the primary year under audit were \$

Gaming workers

Per state gaming regulations, all gaming workers had to volunteer without compensation and all had to be members of the organization.

complied with this requirement by making workers Class A members upon signing into their shift, and terminating membership when they signed out at the end of their shift. The bylaws describe Class A members:

Applicants shall be admitted to membership as a Class A member by placing his or her signature on the staff list immediately prior to the bingo session for which said member is working and upon approval of the session manager. ...such memberships...expire and terminate immediately upon the conclusion of the bingo session for which the membership book relates.

stated that the volunteers from overlapped with the volunteers for the other two organizations that gamed at Bingo. He said that the City didn't like to see the same volunteers listed for multiple organizations. To meet the City's needs, he moved volunteer names between the different gaming charities to ensure there were no repeats.

provided a copy of a volunteer list of names submitted to the City of for the year under audit and copies of the volunteer sign-in sheets for July through September 20 only. He stated that the other nine months' sign-in sheets were lost. The sheets provided meticulously tracked workers names, position, start, and end times. The sheets were hand written and sometimes difficult to read. They appear to list a total of game workers with to workers per session. Of these, only seven matched the list provided to the City.

stated that grant applicants were not required to volunteer, but that the grant program served as an incentive to volunteer, because by doing so they could help the community, including their own children. He stated that 'a parent might volunteer when they need money' to send their child to a private school.

other two organizations shared gaming workers with and gave educational scholarships.

Bingo workers received compensation in the form of food and drink provided during sessions. The organization paid the Deli \$ per gaming customer to cover complementary drinks provided to them. The value of the complementary beverages given to players during sessions can be applied to drinks given to workers. Game workers could also claim a meal allowance valued at \$ each session they worked, though these were not always used. Total value of food and drink available to game workers was \$

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS		Schedule number or exhibit
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Compensated gaming labor

Bingo Managers

stated that the bingo manager was the only compensated gaming employee. The administrative services of a volunteer coordinator were necessary to ensure the sessions ran smoothly. The application for exemption stated that the bingo manager would serve as a volunteer, but by the time of the audit year, bingo manager was paid out of donations made by winning players during gaming sessions. stated that in this way, the organization complies with Penal Code Chapter 9 section 326.5(h) which provides that "Those members [staffing games] shall not receive a profit, wage, or salary from any bingo game." Paragraph (j) says that "profits shall be used only for charitable purposes." All gaming managers compensated out of donations to received Forms W-2.

gaming managers	
2013	
\$	manager
\$	manager
\$	substitute manager
\$	substitute manager
\$	substitute manager
\$	substitute manager
\$	
2012	
\$	manager
\$	manager
\$	substitute manager
\$	substitute manager
\$	

Other compensated labor

Other compensated labor included security at each gaming session; bookkeeping for gaming and grant making; accounting fees for annual return preparation; and legal fees.

total compensation paid	
gaming managers 20	, prorated \$
gaming managers 20	, prorated \$
	\$
	\$
	\$
	\$
	\$
	\$

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS		Schedule number or exhibit
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Law

Operational test – primary purpose

Internal Revenue Code section 501(a) provides that:

An organization described in subsection (c) ... shall be exempt from taxation under this subtitle unless such exemption is denied under section 502

Internal Revenue Code section 501(c)(3) includes:

Corporations ... 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, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation ... , and which does not participate in, or intervene in ... any political campaign on behalf of (or in opposition to) any candidate for public office.

Treasury Regulation section 1.501(c)(3)-1(a)(1) provides 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.

Treasury Regulation section 1.501(c)(3)-1(c)(1) defines "exclusively":

An organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Treasury Regulation section 1.501(c)(3)-1(d)(2) discusses the meaning of "charitable":

The term charitable is used in section 501(c)(3) in its generally accepted legal sense Such term 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; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279, 66 S.Ct. 112, 90 L.Ed. 67 (1945), the Supreme Court wrote that a single non-exempt purpose, if substantial in nature, will disqualify an organization from exemption under IRC section 501(c)(3).

In this instance, in order to fall within the claimed exemption, an organization must be devoted to educational purposes exclusively. This plainly means that the presence of a single non-educational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes. It thus becomes unnecessary to determine the correctness of the educational characterization of petitioner's operations

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
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Operational test – private benefit

An organization does not qualify for exemption under IRC section 501(c)(3) if it serves a private interest. Treasury Regulation section 1.501(c)(3)-1(d)(1)(ii) says:

An organization is not organized or operated exclusively for one or more of the [charitable] purposes specified...unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

In EST of Hawaii v. Commissioner, 71 T.C. 1067 (1979), the tax court found that *although educational in nature, [the organization] served the commercial purposes of the for-profit corporations and petitioner was therefore not operated exclusively for exempt purposes within the meaning of sec. 501(c)(3)*

In P.L.L. Scholarship Fund v. Commissioner, 82 T.C. No. 17, 82 T.C. 196 (1984), an organization with the stated purpose of raising money for scholarship funds conducted bingo games as its primary activity. The games took place in a bar owned by three of the organization's five directors. The Tax Court held that a substantial private purpose of the organization was to attract persons to the bar in the expectation that these persons would purchase food and beverages. The Court held that the organization did not qualify for IRC section 501(c)(3) exemption.

Petitioner was incorporated as a nonprofit corporation under Iowa statutes for the purpose of raising money to be used for providing college scholarships. The money was raised from the operation of bingo games on the premises of the Pastime Lounge. Held, petitioner was not operated exclusively for exempt purposes under the provisions of section 501(c)(3)... and 1.501(c)(3)-1(c)(1).

In KJ's Fund Raisers Inc. v. Commissioner, T.C. Memo. 1997-424 (1997):

The Commissioner determined that petitioner did not meet the section 501(c)(3) requirements for qualification as an exempt organization...[because the] petitioner failed to establish that it operated exclusively for exempt purposes under section 501(c)(3). ... Petitioner engaged in the exempt activity of raising money for charitable purposes. Petitioner also operated for the substantial private benefit of KJ's Place and its owners. A substantial nonexempt purpose thus characterizes its operation, disqualifying it from exemption under sections 501(a) and 501(c)(3).

Operational test – "feeder" organizations

IRC section 502(a) denies exemption to for-profit businesses which donate all profits to charitable organizations:

An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt from taxation under section 501 on the ground that all of its profits are payable to one or more organizations exempt from taxation under section 501.

IRC section 502(b) excepts the following from the term "trade or business":

- (1) the deriving of rents which would be excluded under section 512(b)(3)...
- (2) any trade or business in which substantially all the work in carrying on such trade or business is performed for the organization without compensation, or

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

(3) any trade or business which is the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions.

In Pietz, Inc. v. Commissioner, 82 T.C. No. 16, 82 T.C. 193 (1984), the court found:

Petitioner's sole activity is the operation of bingo games, the profits from which are to be contributed to organizations recognized by the Internal Revenue Service to be exempt from tax under section 501(c)(3).

...
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 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.

...
Petitioner may qualify for exemption only if it directly serves some exempt purpose. Nothing in the record shows that it does so. Therefore, respondent's determination that petitioner is not operated exclusively for exempt purposes must be sustained.

Compensation

IRC section 61 defines gross income as:

all income from whatever source derived, including (but not limited to) ... compensation for services, including fees, commissions, fringe benefits, and similar items

Treasury Regulation section 1.132-6(a) discusses fringe benefits:

Gross income does not include the value of a de minimis fringe provided to an employee. The term "de minimis fringe" means any property or service the value of which is (after taking into account the frequency with which similar fringes are provided by the employer to the employer's employees) so small as to make accounting for it unreasonable or administratively impracticable.

Section 1.132-6(e) provides examples of de minimis fringe benefits:

occasional typing of personal letters by a company secretary; occasional personal use of an employer's copying machine...; occasional cocktail parties, group meals, or picnics for employees and their guests; traditional birthday or holiday gifts of property (not cash) with a low fair market value; occasional theater or sporting event tickets; coffee, doughnuts, and soft drinks; local telephone calls; and flowers, fruit, books, or similar property provided to employees under special circumstances (e.g., on account of illness, outstanding performance, or family crisis).

In Waco Lodge No. 166, Benevolent & Protective Order of Elks, 696 F.2d 372 (1983), the Tax Court found the provision of free beverages to constitute the payment of compensation, but that the amount was small enough to not warrant denial of the 'volunteer exception' from unrelated business income tax.

The Tax Court held that the availability of free beverages to the rest of the workers by itself is sufficient "compensation" to prevent the Lodge from taking advantage of the statutory exemption [from UBI]. In the Tax Court's view, any monetary or non-monetary payment, no matter how small, equals "compensation" under the Code. The question of whether non-monetary "payment" equals "compensation," however, must be decided on the facts of each case. As calculated by the Tax Court, the cost of the free beverages consumed averages to approximately \$2.22 per worker, per

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

night, or about 63 cents an hour. It cannot seriously be argued that the workers were induced to work for this "compensation." We do not believe that the Code's definition of compensation was meant to include such a trifling inducement.

Organization Position

Agent asked for his thoughts on the case in a phone call on June 17, 20 . He stated that he thought that the rent seemed high, but that it might be justified due to overhead expenses. He also said that although there was a personal benefit to the Trust/landlord, was important to the community because of the grants made, even if over half of grants were made to other organizations founded and under the direction of , because of the social and recreational space the organization provided.

Agent provided a draft report Form 886-A to only (at request) on July 23, 20 . The response was received on August 24, 20 and stated as follows:

As we discussed we (and I) observed some items in the Draft that do need correction or clarification as follows:

1. Page 2, "Payments to Dell..." there was no mention of bingo players, so please clarify that the deli serves players.
2. Page 7, Deli, first paragraph, there is not a \$ per player fee to the deli for janitorial costs
3. Page 7, Deli, second paragraph, there is not a \$ fee per "worker" to the deli. The \$ fee is for complimentary drinks, to "players" only.
4. Page 10, Bingo workers, the \$ charge was per "player" only. They do not pay \$ per "worker".
5. Page 10, Bingo workers, the meal allowance of \$ is not always redeemed by the worker. So, it is not something that is automatically collected by the Deli based on the number of workers per session. It is collected only when a worker actually has a meal.

These requests are addressed in the current report.

Government Position

1. Should tax-exempt status under Internal Revenue Code section 501(c)(3) be revoked because operation of a gaming hall is the organization's primary activity, in violation of Treasury Regulation section 1.501(c)(3)-1(c)(1)?

To maintain exemption under IRC section 501(c)(3), an organization must be operated exclusively for exempt purposes. Treasury Regulation section 1.501(c)(3)-1(c)(1) provides the following definitions of "exclusively":

- 1) an organization must engage primarily in activities which accomplish exempt purposes and
- 2) an organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

In other words, to qualify as operated exclusively for exempt purposes, generally at least % of activities must be charitable and no more than % of activities may be non-charitable.

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

Primary activity

An analysis of organizational income and expenses can be used to measure the primary activities. (This analysis allocates accounting expenses equally between gaming and grant making.)

year ending May 20		
Income source	amount	% of income
gross gaming income	\$	%
other contributions	\$	%
total income	\$	
expense	amount	% of expense
<u>gaming expenses</u>		
prizes	\$	
rent	\$	
other	\$	
payments to deli	\$	
salaries	\$	
accounting	\$	
other expenses	\$	
total gaming expenses	\$	%
<u>grant expenses</u>		
payments to related orgs	\$	%
grants	\$	%
accounting	\$	%
total grant expense	\$	
total expense	\$	
net income	\$	

percent of income came directly from gaming or from donations made by winners.
percent of all expenses were directly related to gaming. Only % of all expenses were grants to unrelated, tax-exempt organizations.

An analysis of time and resources consumed can also be used to determine the primary activities.
conducted gaming three days per week on a year-round basis. Each session required six to eight game workers, a manager, and a security guard. Direct gaming activity alone required a minimum of eight workers per session and hours annually (workers x 6 hours per session x 3 sessions per week x 52 weeks per year). The gaming activity also required a portion of bookkeeping, accounting, and legal activity.

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

The grant making program, on the other hand, took only a few hours of _____ and the bookkeeper's time each quarter. A total of _____ grants were made in the audit year. If we allow an hour for the process of awarding and accounting for each check, grants account for _____ hours out of _____ total hours annually. Again, a portion of bookkeeping, accounting, and legal time is not included in the total hours; if included it would only reduce the grant program's portion of hours used.

There can be little question that _____ primary activity was gaming. Gaming accounted for _____ % of income, _____ % of expenses, and _____ % of activity time. The organization did not engage primarily in grant making and engaged more than insubstantially in gaming.

Exempt-purpose activity

operation as a whole must be considered to determine if the gaming activity was operated for tax-exempt purposes. Factors to consider include the following:

- o _____ has been engaged in bingo and gaming since its inception in 20 _____. The high cost of gaming operations in the examined year was not due to start-up costs, and remained constant at least through the 20 _____, 20 _____, and 20 _____ Forms 990.
- o The size and extent of gaming activities was significantly larger than the size and extent of any potential charitable activity. Gaming was operated three days per week, six hours per day and utilized eight to ten active workers per session, plus the administrative support of a bookkeeper, accountant, and attorney. The grant program took only a few hours of two people's time each year.
- o Gaming produced over \$ _____ million in revenue while the grant program was valued at \$ _____, only _____ % of gross income.
- o \$ _____ of the grants made, roughly _____ %, were made to related organizations.
- o Only \$ _____ in grants was made to independent charitable organizations — _____ % of gross income.
- o The largest recipients of organization funds after prizes were:
 - o \$ _____ to the gaming hall landlord (an LLC which ultimately benefitted _____ father)
 - o \$ _____ for various gaming supplies and expense
 - o \$ _____ in payments to the gaming hall deli (owed by _____ brother)
 - o \$ _____ to related organizations
- o A substantial portion of gaming income was used up by administrative and overhead.
- o Average monthly rent paid was over \$ _____, an exorbitant amount for an organization whose purpose was to raise money for charity.
- o The organization did not state a specific amount (flat rate or percent of net income) to be used for grants. This does not indicate that a charitable grant program was an integral part of the organization's purpose.
- o Gaming was advertised to the public to draw more customers. Over \$ _____ was spent on advertising.
- o The conduct of gaming was unrelated to the organization's exempt purpose aside from the need to generated income

These factors show that the gaming activity had no charitable purpose. The predominant orientation of the organization was directed toward running a business with no exempt purpose. In this context, the turnover of only _____ % of gross income for charitable purposes was not sufficient to retain tax-exempt status under IRC section 501(c)(3).

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

"Feeder" organizations

IRC section 502 provides that an organization cannot be granted exemption simply because all profits from its trade or business are remitted to tax-exempt organizations, unless it is substantially all operated with non-compensated labor. Generally "substantially all" is taken to mean 85%.

does not qualify for this exemption from the disqualification under IRC 502 because the gaming activity is not substantially all volunteer-run. Each gaming session required workers. Two of these workers (the gaming manager and the security guard) were compensated in cash on an hourly basis. The remaining game workers were compensated with beverages and meals valued at \$. The bookkeeping, accounting, and legal services were also compensated.

compensated hours calculation

workers per session x 6 hours/session x 3 sessions/week x 52 weeks/year			
bingo manager x 6 hours/session x 3 sessions/week x 52 weeks/year			
security guard x 6 hours/session x 3 sessions/week x 52 weeks/year			
accountant x	manager hours x	% estimate x	% allocation to gaming
CPA firm: \$	charged annually / \$	per hour x	% allocation to gaming
Attorney: \$	charged annually / \$	per hour x	% allocation to gaming
total compensated hours			

The only non-compensated worker was

In Waco Lodge No. 166 Benevolent & Protective Order of Elks v. Commissioner, the tax court found that free beverages to game workers constituted compensation, but that the compensation amount was de minimus for the purposes of determining the applicability of the exception from tax in that case. In the case of , it is the government's position that the free beverages and meals given to game workers were compensation and should disqualify the business from the IRC section 509(b) exception to exclusion from tax-exempt status. The beverages and meals afforded game workers were more substantial than beverages given in the Elks case and in the "coffee, doughnuts, and soft drinks" example given in IRC section 1.132-6(e). Furthermore, unlike the Code examples, the free beverages and meals were given on a regular basis, to every game worker at every shift, not "occasionally." Finally, if the game workers are not considered compensated, the games were still not substantially all uncompensated. Compensated hours not including game workers were % of all hours; uncompensated hours were only %, not substantially all hours.

conducted two activities: gaming and grant making. It is the government's position that the gaming activity was the primary activity and it was not charitable. Additionally, the charitable grant making program was insubstantial. In this way, the organization violated both components of the operational test contained within Treasury Regulation section 1.501(c)(3)-1(c)(1). has failed to be operated exclusively for exempt purposes. Furthermore, the organization is disqualified from tax-exempt treatment under IRC section 502 because substantially all of the work performed on behalf of the organization is not carried out without compensation. The organization no longer qualifies for tax-exempt status under IRC section 501(c)(3).

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

2. Should the organization be revoked because it has a more than insubstantial non-exempt purpose of providing private benefit to the gaming hall landlord in violation of Treasury Regulation 1.501(c)(3)-1(d)(1)(ii)?

This report has made an in-depth analysis of the primary purpose of _____ and the activities that the organization engaged in to achieve that purpose. The primary activity of the organization has been found to be the operation of a gaming hall. What is the purpose of conducting this activity? An analysis of expenses shows the following. (This does not include prize expenses, which run at _____ % of gaming income, and are substantially larger than any other expense.)

expense	amount	% of expense
gaming rent	\$	%
other gaming expenses	\$	%
payments to deli	\$	%
grants to related orgs	\$	%
accounting	\$	%
grants	\$	%
salaries	\$	%
other expenses	\$	%

Fifty-one percent of the expenses listed here are paid, ultimately, to family members of the organization's founder and president.

The payments to the _____ Deli, which is owned by _____ brother, appear to be reasonable. The per-session charges were \$ _____ per player to cover the cost of complementary soda and coffee provided to customers; a \$ _____ fee to cover janitorial expenses; and reimbursement for food 'bought' by customers with 'player's reward points.' While total payments to the Deli are significant, they are defensible.

Rental payments for the _____ Bingo hall, however, constituted private benefit. Rent payments averaged \$ _____ per session and \$ _____ per month. These rental amounts are more than insubstantial.

_____ had no contemporaneous documentation showing the amount of rent was determined in a way similar to an arms-length transaction. The only available contemporaneous documentation is the application for exemption, Form 1023. Several of _____ statements made on the form were disingenuous because he implied that the landlord and other tenants at the hall were unrelated parties. This was not the case as the landlord, via a chain of relationships, is ultimately _____ father and _____ founded the other organizations that rented the hall. From the application correspondence:

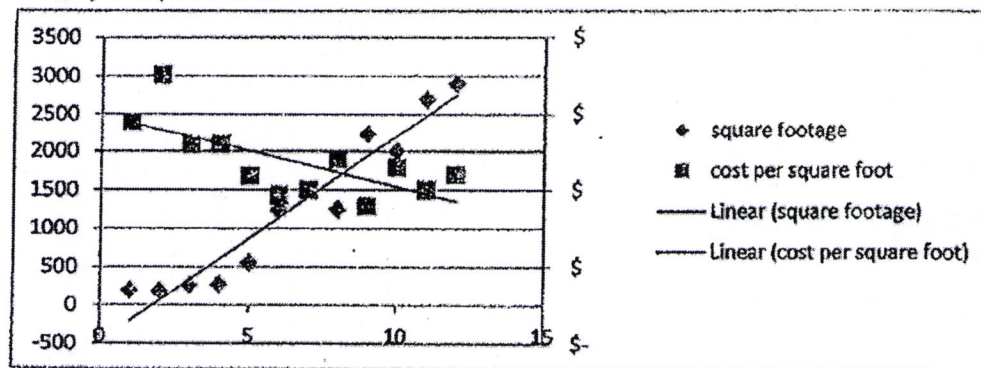
- o *The bingo sessions will likely be conducted at _____*
- o *The bingo hall owner is not represented on the Applicant's Board of Directors. ... To the best of the Applicant's knowledge, the bingo hall owner is not represented on the boards of directors of any of the non-profit organizations represented at the hall.*
- o *Applicant has not yet negotiated the rental of the bingo facility. The budget [of \$ _____ per session] is based upon the rental paid by other organizations for that facility.*
- o *...fixed sum is the same rate paid by all of the other non-profit organizations represented at the hall. Applicant believes that this rate has been in effect for several years.*

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

A 2015 survey of area business and retail spaces for rent finds the following:

description	square footage	monthly rent	cost per square foot
downtown office suite		\$	\$
downtown office suite		\$	\$
downtown office space		\$	\$
office		\$	\$
small warehouse		\$	\$
medical office suite		\$	\$
shared storefront		\$	\$
downtown office/retail space		\$	\$
downtown retail		\$	\$
downtown office space		\$	\$
downtown restaurant		\$	\$
downtown retail office space		\$	\$

As square footage increases, the cost per square foot decreases. This chart shows the relationship of rental size to cost per square foot.



The area of Bingo used by was square feet. Annual rent charged for use of the space one third of the time was \$ or \$ for full annual rental. This equates to \$ per square foot, well above the highest amount paid for the smallest space available.

If we use the lowest cost per square foot found for the largest comparable space to estimate the fair market value of Bingo, we get annual rent of \$ (x \$ x) or \$ for one third usage. Compared to rent paid of \$, private benefit was \$.

One of purposes was to provide private benefit to the gaming hall landlord, which was the father of founder and president. This was accomplished by paying annual rent \$ over fair market value. Per Treasury Regulation 1.501(c)(3)-1(d)(1)(ii), an organization cannot qualify for exemption if it serves a private rather than a public interest. tax-exempt status should be revoked.

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

Conclusion

tax-exempt status under Internal Revenue Code section 501(c)(3) be revoked because it failed the primary purpose test under Treasury Regulation section 1.501(c)(3)-1(c)(1). The organization's primary activity was operation of a gaming hall for non-charitable purposes. Any charitable grant making activity was insubstantial.

Additionally, was operated more than insubstantially for the private benefit of the gaming hall landlord through the payment of above market rate rent. Treasury Regulation 1.501(c)(3)-1(d)(1)(ii) prohibits tax-exempt status under Internal Revenue Code section 501(c)(3) of any organization that has a non-exempt purpose which is more than insubstantial. The organization's tax-exempt status should be revoked.

is no longer a tax-exempt entity under IRC section 501(c)(3) as of June 1, 20, the earliest date examined as a part of this audit. Is liable for filing Form 1120, not Form 990-T, to report income as of June 1, 20.