



DEPARTMENT OF THE TREASURY
Internal Revenue Service
TE/GEEEO Examinations
1100 Commerce Street, MC 4920DAL
Dallas, TX 75242

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: **MAY 30 2017**

Release Number: **201750019**
Release Date 12/15/2017
UIL Code: 501.04-00

Taxpayer Identification Number:

Person to Contact:

Employee Identification Number:

Employee Telephone Number:

CERTIFIED MAIL - Return Receipt Requested

Dear _____,
operating under the name _____

and/or _____

This is a Final Adverse Determination Letter as to your exempt status under section 501(c)(4) of the Internal Revenue Code. Your exemption from Federal income tax under section 501(c)(4) of the Code is hereby revoked effective July 1, 20xx.

Our adverse determination was made for the following reasons:

Organizations described in Section 501(c)(4) of the Code must be organized and operated exclusively for the promotion of the common good and general welfare of the people of the community. The operations of these organizations bring about civic betterment and social improvements that affect a whole community rather than a private group of citizens. Our examination of your activities and finances revealed that your operations are not conducted exclusively for the common good and social welfare of the community as a whole. Therefore, you are not operated for an exempt purpose as described in Section 501(c)(4) of the Code.

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code.

You are required to file Federal income tax returns on Form 1120. If you have not already filed these returns and the agent has not provided you instructions for converting your previously filed Form 990 to Form 1120, you should file these income tax returns with the appropriate Service Center for the tax year ending June 30, 20xx and for all tax years thereafter 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, you may file an action for declaratory judgment under the provisions of section 7428 of the Code in one of the following three venues: United States Tax Court, the United States Court of Federal Claims, or the United States District Court for the District of Columbia. A petition or complaint in one of these three courts must be filed before the 91st day after the date this determination was mailed to you if you wish to seek review of our determination. Please contact the clerk of the respective court for rules and the appropriate forms regarding filing petitions for declaratory judgment by referring to the enclosed Publication 892. Please note that the United States Tax Court is the only one of these courts where a declaratory judgment action can be pursued without the services of a lawyer. You may write to the courts at the following addresses:

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

US Court of Federal Claims
717 Madison Place, NW
Washington, DC 20005

U. S. District Court for the District of Columbia
333 Constitution Ave., N.W.
Washington, DC 20001

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

Sincerely yours,

Maria Hooke
Director, Exempt Organizations Examinations

Enclosures:
Publication 892



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

Date: December 30, 2016

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

June 30, 20xx

Person to Contact/ID Number:

Contact Numbers:

Manager's Name/ID Number:

Manager's Contact 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)(4) 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)(4).

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,

Mary A. Epps
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 06/30/20xx

ISSUE

- Whether the tax-exempt status of (The "Post") should be revoked because it is not operated exclusively for social welfare purposes

FACTS

Exempt Status

The Post received an exemption letter dated July 5, 19xx from [redacted] that indicated it was part of a group exemption under Section 501(c)(4) of the Internal Revenue Code. The group number was xxxx.

On February 1, 20xx, the Post received Letter 4901 from the Internal Revenue Service (the "Service"). Letter 4901 stated that the Post was no longer a subordinate in a revoked group ruling. Letter 4901 also informed the Post that it could hold itself out as exempt if it met the requirements of the Internal Revenue Code. The Form 990, *Return of Organization Exempt from Income Tax*, for fiscal years ending June 30, 20xx, June 30, 20xx and June 30, 20xx showed the Post checked that it's tax exempt status is 501 (c)(19).

The Post's Quartermaster filed the Form 990 returns. The Quartermaster is a licensed Public Accountant in the state of [redacted] and an Enrolled Agent with the Service. The Quartermaster contacted the Service in 20xx regarding the group ruling revocation notice. The Quartermaster was advised by the Service to continue to file the Form 990. The Quartermaster reported the Post's exempt status as 501 (c)(19) in error due to a misunderstanding between the state of [redacted] and federal rules.

Operations and Activities

The Post facility consists of the "[redacted]" (the, "Club"), which the Post also calls the "[redacted]". The Club is located at [redacted] and operates a bar and gaming operation that is open to the public. The Post also offers regular bingo twice a month from October through May at the Club. The Post members volunteer for the bingo activity. The Post also offers raffles, live poker and sports betting. All proceeds are distributed back to the winners.

The Post bar and gaming operations are open to the public six (6) days a week from 9:00 a.m. to 11:00 p.m. The operating hours may extend to 2:00 a.m. if patrons are present. The Service toured the Post on Wednesday, December 14, 20xx. The Service observed the outside of the Post has a sign painted on the building that says, "Public Welcome." (See Attachments 1 and 2.)

The Service observed the Post meeting room, the bar manager's office, storage areas, a bar that served alcohol, soft drinks and snacks, a pool table, betting board, ATM machine, juke box, and

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seven (7) gaming machines. The gaming machines offered many games under Keno, Poker and Reel, which is similar to a slot machine.

A patron chooses a game to play and inserts money directly into the machine. If the player wins a cash prize, the machine issues the player a credit that he or she can redeem at the bar. The machine payouts do not exceed \$xxx per play per the state of regulations. The Post was not required to issue Forms W2-G, pay back-up withholding or excise taxes.

Prior to the year 20xx, the Post limited access to the public through a sign-in sheet. However, the Post discontinued using the sign-in sheet when it learned that it owned its state fraternal license. Since the Post was not required to have a sign-in sheet for its state license, the Post assumed it was not required to have a sign-in sheet for federal purposes.

The Post regularly prepares a National Program's Report to declare its community activities. The Service reviewed the report for the period of December 1, 20xx through November 30, 20xx. The Post reported xxx community hours during this period and that it spent \$x,xxx on community projects. The report showed the Post completed xx community projects. The projects consisted of , Bingo games and free meals, aiding others through the

, farmers and churches. The Post also assisted home and youth programs. During this same period, the Post performed over x,xxx hours in its bar and gaming activities.

The Post is in compliance with all state and local license regulations for alcohol and gaming.

Profit Sharing

The Post had a profit sharing contract with and leased its gaming machines from them. performed weekly audits of the gaming operations and produced weekly Gaming Activity Reports that reconciled to the Post's financial records. The Post received xx percent of the gross revenue before applicable taxes.

The Post employs only bartenders which includes a bar manager. During the years 20xx and 20xx, the Post employed xx bartenders. The Post had high turnover and had to refill positions. The Post attempts to retain bartenders and encourages employees to help the Post become profitable through its profit sharing arrangement. The Profit Sharing Plan is directed to the Post's employees and states, "

." The higher the bar's profit, the higher the employee's share of the profit. Profit sharing was included on the employees' Form W2. Applicable taxes were paid.

Net Operating Loss

The Post verified a net operating loss (NOL) of (\$xx,xxx) that is available against its net profit related to operations. The net profit for the examination year ending June 30, 20xx is \$xx,xxx. The Post used all of its prior NOLs and does not need to carry back. The following chart shows when the NOL's became available, how they were used, and the amount currently available.

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
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Unsorbed Net Operating Loss

<u>Date</u>	<u>Amount</u>	<u>Balance</u>
6/30/20xx	(xx,xxx)	(xx,xxx)
6/30/20xx	x,xxx	(xx,xxx)
6/30/20xx	(x,xxx)	(xx,xxx)
6/30/20xx	(x,xxx)	(xx,xxx)
6/30/20xx	(x,xxx)	(xx,xxx)
<u>NOL Available 6/30/20xx</u>		(xx,xxx)
<u>20xx Operations Profit</u>		<u>xx,xxx</u>
<u>Available NOL 6/30/20xx</u>		<u>(xx,xxx)</u>

Income and Expenses

The charts below show the sources of income for the current year. Income sources are similar for at least xx prior years.

Current Year Operations Income

Beer Sales	xx,xxx.xx
Mixed Drinks/Liquor Sales	xx,xxx.xx
Miscellaneous Income	x,xxx.xx
Sales- Video Gambling	xxx,xxx.xx
Sales - Live Poker Fundraiser	xxx.xx
Jukebox, Pool, Boards	x,xxx.xx
Funeral Detail	xxx.xx
ATM Fee Income	xxx.xx
Total Operations Income	xxx,xxx.xx

Current Year Non Operations Income

Donations Received	xx.xx
Interest Income	xx.xx
State, Nat'l Dues Income	xxx.xx
Total Non-Operations Income	xxx.xx

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
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The charts below show the expenditures for the current year. Expense types are similar for at least xx prior years.

Current Year Operations Expenditures

<u>Type of Expense</u>	<u>Amount</u>
Beer/Wine	xx,xxx.xx
Mixed Drinks/ Liquor	xx,xxx.xx
Gambling/Payouts/Fees	xxx,xxx.xx
Jukebox/Pool Table	x,xxx.xx
Payroll Expense	xx,xxx.xx
Miscellaneous Operations	xx,xxx.xx
Total Operations Expense	xxx,xxx.xx

Current Year Non-Operations Expenses

State, Nat'l Dues Expense	xxx.xx
Total Non-Operations Expenses	xxx.xx

LAW

Section 501(c)(4)(A) of the Internal Revenue Code, (the "Code") provides for exemption from federal income tax for civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

Section 1.501(c)(4) of the Federal Tax Regulations, (the "Regulations") provides that an organization may be exempt as an organization described in section 501(c)(4) if it is not organized for profit and it is operated exclusively for the promotion of social welfare.

Section 1.501(c)(4) of the Regulations provides that being operated exclusively for social welfare means that an organization is primarily engaged in promoting in some way the common good and general welfare of the people of the community.

In Revenue Ruling 66-150, 1966-1 C.B. 147, a subsidiary of a veterans organization whose primary purpose was operating social facilities for members and bona fide guests including a bar, restaurant, and game room was denied exemption under section 501(c)(4) of the Code. That revenue ruling reasoned that for an organization to be exempt under section 501(c)(4) of the Code, it must be operated primarily for the purpose of bringing about civic betterments and social improvements. Revenue Ruling 66-150 concluded that: (a)n organization is not operated primarily

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
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for the promotion of social welfare if its primary activity is operating a social club for the benefit, pleasure, or recreation of its members.

In Revenue Ruling 68-46, 1968-1 C.B. 260, a war veterans' organization did not qualify for exemption from federal income tax under section 501(c)(4) of the Code because it was primarily engaged in renting a commercial building and operating a public banquet and meeting hall having bar and dining facilities.

In Revenue Ruling 60-324, 1960-2 C.B. 173, the Service stated that: [w]hile [the] Regulations indicate that a club may lose its exempt status if it makes its facilities available to the general public, [it] does not mean that any dealings with outsiders will automatically cause a club to lose its exemption. A club will not lose its exemption merely because it receives some income from the general public, that is, persons other than members and their bona fide guests, or because the general public may occasionally be permitted to participate in its affairs, provided such participation is incidental to and in furtherance of its general club purposes and the income therefrom does not inure to members.

Revenue Procedure 71-17, 1971-1 C.B. 683, provides the impact of an organization's nonmember gross receipts on its exempt status under section 501(c)(7) of the Code. The revenue procedure provides that "[a] significant factor reflecting the existence of a nonexempt purpose is the amount of gross receipts derived from use of a club's facilities by the general public." The revenue procedure went on to provide a safe harbor for organizations serving the general public: As an audit standard, [the gross receipts derived from the general public] alone will not be relied upon by the Service if annual gross receipts from the general public for [use of the club's facility] is \$2,500 or less or, if more than \$2,500, where gross receipts from the general public for use is five percent or less of total gross receipts of the organization.

Revenue Procedure 71-17, 1971-1 C.B. 683 defines the term "general public" as persons other than members or their dependents or guests for an organization exempt under section 501 (c)(19) of the Code. Section 3.03 of Revenue Procedure 71-17 provides four instances in which nonmembers are assumed to be the guests of the members. The assumptions include:

- 1) Where a group of eight or fewer individuals, at least one of whom is a member, uses club facilities, it will be assumed for audit purposes that the nonmembers are the guests of the member, provided payment for such use is received by the club directly from the member or the member's employer.
- 2) Where 75 percent or more of a group using club facilities are members, it will likewise be assumed for audit purposes that the nonmembers in the group are guests of members, provided payment for such use is received by the club directly from one or more of the members or the member's employer.

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer	Tax Identification Number	Year/Period ended 06/30/20xx

GOVERNMENT'S POSITION

Veterans' organizations can be described under section 501(c)(4) of the Code not because of the composition of their membership, but because they are engaged primarily in activities which promote social welfare purposes. This is in contrast to war veteran's organization exempt under section 501(c)(19) of the Code, which are required to meet specific requirements concerning the composition of their membership. Unlike section 501(c)(19) exempt status veterans' organizations, the provision of social and recreational activities for members of an section 501(c)(4) exempt status veterans' organization is not an exempt purpose activity even if such members are veterans.

There are no membership requirements under section 501(c)(4) of the Code. Exemption is based solely on the type of activities conducted. Membership requirements can be set by the post or its central organization and include any category of members that is allowed by its charter.

Social Welfare Activities

Social welfare activities include promoting; sponsoring and participating in patriotic activities such as Fourth of July parades, school Flag Day ceremonies and Junior ROTC groups. Assisting needy and disabled veterans, widows, or orphans of deceased veterans as well as conducting hospital visits, driving the sick and disabled to the hospital or to medical facilities, recycling, adopting a road for clean up purposes, and sponsoring a youth baseball team, or other youth groups, are also social welfare activities.

The social welfare activities listed above are not exclusive. The Post demonstrated that it was involved in social welfare activities; however, the hours spent on community activities were minimal.

Bar and gambling activities conducted by veterans organizations exempt under section 501(c)(4) do not promote the social welfare of the community regardless of whether members or nonmembers participate in them because they do not promote the general welfare of the community as required under section 501(c)(4).

There is nothing inherently beneficial to the community from having gambling activities available. In fact, many sectors of the community might consider it detrimental as is evidenced by the fact that in most jurisdictions gambling activities are either illegal or severely limited.

Revenue Ruling 66-150, 1966-1 C.B. 147, provides that a subsidiary of a veterans organization whose primary purpose was operating social facilities for members and bona fide guests including a bar, restaurant, and game room was denied exemption under section 501(c)(4). That revenue ruling reasoned that for an organization to be exempt under section 501(c)(4), it must be operated primarily for the purpose of bringing about civic betterments and social improvements. Operation of a bar, restaurant, and game room are not social welfare activities under section 501 (c)(4).

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer	Tax Identification Number	Year/Period ended 06/30/20xx

Public Use of Facilities

In Revenue Ruling 68-46, 1968-1 C.B. 260 , a war veterans' organization did not qualify for exemption from Federal income tax under I.R.C. § 501(c)(4) because it was primarily engaged in renting a commercial building and operating a public banquet and meeting hall having bar and dining facilities. Likewise, the Post is operating a public bar that also includes public gaming operations.

In Revenue Ruling 60-324, 1960-2 C.B. 173, the Service stated that a club would not lose its exemption for receiving some income from the public as long as the involvement with the general public was occasional and incidental. Conversely, the Post's involvement with the public is daily with the exception of Sundays and its income from the public is the basically 100% of its revenue.

In West Side Tennis Club v. Commissioner, 111 F.2d 6 (2nd Cir. 1940), the Second Circuit upheld the board of tax appeals determination that a social club was not exempt because a substantial amount of its income was received from the general public. Likewise, a substantial amount of the Post's income was received from the general public. Less than x%(percent) of the Post's income is from member dues and other non-operations income.

The Post spends most of its time operating the bar and gaming activities. The Post spent xxx hours performing community activities in comparison to over x,xxx hours operating the bar and gaming. Similarly, the Post's income is exclusively from the bar and gaming activities. Income from Club related operations was over \$xxx,xxx. Conversely, the amount of income received from dues is less than \$xxx. Less than x% of the Post's income is from activities that are not related to the bar and gaming business.

Likewise, the Post's expenditures are exclusively related to the bar and gaming operations. Expenditures related to the Club operations were over \$xxx,xxx. However, expenditures on operations not related to the Club are less than \$xxx. Although the business operations show a net loss for (x) of the past (xx) years, the Post operates the Club in a business-like manner and is working towards making the activity profitable. The Post also shows its intention to operate a for profit business by the type of income and expenditures it has, its contractual profit split with , and its employee profit sharing arrangement. Additionally, the Post is open to the public for at least xx hours a day days a week and has paid employees performing the operations.

In Pittsburgh Press Club v. United States, 615 F.2d 600 (3rd Cir. 1980), the Third Circuit upheld the Commissioner's determination that a social club failed to qualify for exemption from income tax as an organization exempt under section 501(c)(7) of the Code because it was operated for business and not for the pleasure and recreation of its members. The determining factor was the amount of non-member receipts from the public not the number of years with or without a net profit.

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer	Tax Identification Number	Year/Period ended 06/30/20xx

The conduct of business with the general public in a manner similar to for-profit organizations does not promote the accomplishment of social welfare purposes. However, such conduct of business with the general public on a for profit basis, does not preclude exemption under section 501(c)(4) of the Code so long as such business with the general public, along with any other activities that do not promote social welfare purposes, are not the primary activities of the organization. However, the Post is conducting business with the public as its primary activity.

Unfair Business Competition

The Post showed a profit for its gaming activities for the years 20xx through 20xx. The Post also received income from liquor, non-alcoholic drinks, snacks, jukebox, pool and boards play, but did not show a profit during the same years from these activities. The Post determined that the gaming activity subsidized the bar activity.

_____ has a population of approximately xxx persons. An internet search showed there is at least one for-profit corporation called the _____ in _____. Additionally, other businesses operate bar drink services in _____. Gaming is also allowable as a legal for-profit business in the state of _____. An internet search showed there are over xx gaming operations within xx miles of _____. The Club is in unfair competition with any local bar and gaming businesses that are required to pay income tax.

Not Exempt under section 501 (c)(19) of the Code

The Post ceased being included in the group ruling under group xxxx in the year 20xx. Afterwards, the Post self-declared its exempt status on Form 990. The Post did not self-declare as a section 501 (c)(4) exempt organization on any of the Post's prior returns the Service reviewed. An organization cannot self-declare as a section 501 (c)(19) organization. It must obtain a determination from the Service that it is recognized under the 501 (c)(19) exempt status.

Additionally, the Post failed to maintain records to delineate between income derived from members and non-members. The bar and gaming activities were conducted in a commercial manner. Public operations were not irregular. The Post is not exempt under section (c)(19) of the Code.

CONCLUSION

The tax exempt status of the Post should be revoked since the Post is not exclusively operated for social welfare purposes. Operating a bar or gaming operation for members or for the public does not promote social welfare as required under section 501 (c)(4) of the Code.

Additionally, the Post does not have a valid exempt status under Section 501(c)(19). The Post did not account separately for member and non-member income and it did not receive a determination that it was recognized under the section 501(c)(19) of the Code. The Post cannot self-declare it is exempt under section 501 (c)(19). The Post may apply for any Veteran's exempt status for which

Form **886-A**
(Rev. January 1994)**EXPLANATIONS OF ITEMS**

Name of taxpayer

Tax Identification Number

Year/Period ended
06/30/20xx

it qualifies once it is no longer operating the
Application for Recognition of Exemption Under 501(a).

activities by filing Form 1024,