



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: August 2, 2018

Release Number: 201846007

Release Date: 11/16/2018

UIL Code: 501.03-00

Tax Year Ending:

June 30, 20XX

Taxpayer Identification Number:

Person to Contact:

Employee Identification Number:

Employee Telephone Number:

(Phone)

(Fax)

CERTIFIED MAIL -- RETURN RECEIPT

Dear _____ :

This is a final determination that you do not qualify for exemption from Federal income tax under Internal Revenue Code (the "Code") section 501(a) as an organization described in Code section 501(c)(3) effective July 1, 20XX. Your determination letter dated March 11, 19XX is revoked.

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

Organizations described in section 501(c)(3) of the Internal Revenue Code and exempt from tax under section 501(a) must be both organized and operated exclusively for exempt purposes. You operated a for-profit commercial business by promoting and presenting professional tribute band concerts. Also, your rental and services activities are commercial and lacking a charitable purpose. Also, you exclusively used the for-profit catering company owned by your officers to provide all catering services to you for your fundraising events. The catering company benefited from its dealings with you thereby causing you to fail to operate for public purposes under Reg. 1.501(c)(3)-1(d)(1)(ii). These dealing are also inurement from you to the benefit of the catering company.

Contributions to your organization are no longer deductible under IRC §170 after July 1, 20XX.

Organizations that are not exempt under section 501 generally are required to file federal income tax returns and pay tax, where applicable. For further instructions, forms, and information, please

visit www.irs.gov.

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 and the appropriate forms for filing petitions for declaratory judgment by referring to the enclosed Publication 892. You may write to the courts at the following addresses:

United States Tax Court
400 Second Street, N.W.
Washington, D.C. 20217

U.S. Court of Federal Claims
717 Madison Place, N.W.
Washington, D.C. 20439

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

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

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 www.taxpayeradvocate.irs.gov or call 1-877-777-4778.

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

Sincerely,

Maria Hooke
Director, EO Examinations

Enclosure:
Publication 892



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

Date: March 29, 2018

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

June 30, 20XX

Person to Contact:

Employee ID:

Telephone:

Fax:

Manager's Contact Information:

Employee ID:

Telephone:

Response Due Date:

April 30, 2018

CERTIFIED MAIL – Return Receipt Requested

Dear :

Why you're receiving this letter

We enclosed a copy of our audit report, Form 886-A, Explanation of Items, explaining that we propose to revoke your tax-exempt status as an organization described in Internal Revenue Code (IRC) Section 501(c)(3).

If you agree

If you haven't already, please sign the enclosed Form 6018, Consent to Proposed Action, and return it to the contact person shown at the top of this letter. We'll issue a final adverse letter determining that you aren't an organization described in IRC Section 501(c)(3) for the periods above.

After we issue the final adverse determination letter, we'll announce that your organization is no longer eligible to receive tax deductible contributions under IRC Section 170.

If you disagree

1. Request a meeting or telephone conference with the manager shown at the top of this letter.
2. Send any information you want us to consider.
3. File a protest with the IRS Appeals Office. If you request a meeting with the manager or send additional information as stated in 1 and 2, above, you'll still be able to file a protest with IRS Appeals Office after the meeting or after we consider the information.

The IRS Appeals Office is independent of the Exempt Organizations division and resolves most disputes informally. If you file a protest, the auditing agent may ask you to sign a consent to extend the period of limitations for assessing tax. This is to allow the

IRS Appeals Office enough time to consider your case. For your protest to be valid, it must contain certain specific information, including a statement of the facts, applicable law, and arguments in support of your position. For specific information needed for a valid protest, refer to Publication 892, How to Appeal an IRS Determination on Tax-Exempt Status.

Fast Track Mediation (FTM) referred to in Publication 3498, The Examination Process, generally doesn't apply now that we've issued this letter.

4. Request technical advice from the Office of Associate Chief Counsel (Tax Exempt Government Entities) if you feel the issue hasn't been addressed in published precedent or has been treated inconsistently by the IRS.

If you're considering requesting technical advice, contact the person shown at the top of this letter. If you disagree with the technical advice decision, you will be able to appeal to the IRS Appeals Office, as explained above. A decision made in a technical advice memorandum, however, generally is final and binding on Appeals.

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 adverse determination letter.

Contacting the Taxpayer Advocate Office is a taxpayer right

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 www.taxpayeradvocate.irs.gov or call 877-777-4778.

For additional information

You can get any of the forms and publications mentioned in this letter by visiting our website at www.irs.gov/forms-pubs or by calling 800-TAX-FORM (800-829-3676).

If you have questions, you can contact the person shown at the top of this letter.

Sincerely,



for Maria Hooke
Director, Exempt Organizations
Examinations

Enclosures:
Form 886-A
Form 6018
Form 4621-A

Form 886-A (May 2017)	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule number or exhibit N/A
Name of taxpayer	Tax Identification Number (last 4 digits)	Year/Period ended June 30, 20XX June 30, 20XX

Issue

Whether _____ section 501(c)(3) exempt status should be revoked on the grounds that:

- 1) It has engaged in a substantial non-exempt purpose, and
- 2) Its earnings have resulted in private benefit.

Facts

_____ () was incorporated in the State of _____ on June 13, 19XX. Its purpose, as stated in an amendment (filed August 6, 19XX) to its Articles of Incorporation, is "to provide the public with education in the theater arts". The Internal Revenue Service (IRS) issued a determination letter, dated March 11, 19XX, recognizing _____ as tax-exempt under Internal Revenue Code (IRC) section § 501(c)(3). The letter stated that _____ was not a Private Foundation because it was an organization described in IRC § 509(a)(2). To date, this determination has not been changed.

_____ initially engaged in producing theatrical productions presented at its leased facility, a theater. In addition, the Organization allowed use of the theater and provided some staging support to a few other community theater groups. The Organization also allowed occasional use of the theater by the City for meetings. Fundraising events were held at the theater on occasion to benefit the Organization (i.e. wine walk, benefactor event).

_____ (Chair/Director) and _____ (Treasurer/Director) are the Organization's founders and primary officers. They are also the founders and Trustees of the _____. The _____ also own a for-profit catering company, _____ (also known as _____), which provided services to _____ for its fundraising events.

The Organization's theater facility is leased from the _____, a Private Foundation exempt under IRC § 501(c)(3). The facility also includes banquet room, a bar area, concession and reception area. The lease document provided (effective June 1, 20XX) indicates the lease is renewable annually upon notification with \$0 rent payable monthly. _____ is responsible for paying the utilities and the Foundation is responsible for property taxes and major repairs.

The Board of Director Meeting Minutes for the indicated periods reveal the following:
October 20XX – March 20XX

- Overhead costs to keep the theater open was estimated at \$0/day.
- The Board expressed concern at maintaining a positive cash flow for each event held (i.e. cost cutting methods and fundraising).

Explanation of Items

Name of taxpayer

Tax Identification Number (last 4 digits)

Year/Period ended
June 30, 20XX
June 30, 20XX

January 14, 20XX

- The theater was not being sold or shut down.
- Effective 20XX the Organization will only book tribute bands and no longer stage plays or musicals.

December 8, 20XX

- It was reported that nearly all the concerts since August had made a profit and the "decision to do concerts and not productions was a good move at this time."
- It was indicated the " " had to contribute only \$0 to keep doors open."

The 20XX and 20XX theater schedules listed the following events:

Date	Name	Type of event
July 10-11, 20XX	/	Tribute Band
July 17-18, 20XX		Tribute Band
July 24-August 1, 20XX	& Productions (by) ①	Play/Musical
August 13-16, 20XX		Musical
August 21-22, 20XX		Tribute Band
August 28-29, 20XX		Tribute Band
September 11-12, 20XX		Tribute Band
September 18-19, 20XX	②	Dinner Theater
September 24-27, 20XX		Musical
October 2-18, 20XX		Musical
October 23-24, 20XX		Tribute Band
November 13- December 13, 20XX		Musical
January 29-31, 20XX		Tribute Band
February 19-20, 20XX		Tribute Band
February 27, 20XX		Tribute Band
March 4-5, 20XX		Tribute Band
March 18-19, 20XX		Tribute Band
April 8-9, 20XX		Tribute Band
April 23, 20XX		Tribute Band
May 20-22, 20XX		Tribute Band
June 10, 20XX		Tribute Band

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June 24-25, 20XX	Tribute Band
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- ① Produced by the indicated theater group using their instructed youth performers. lighting and sound employees used at theater.
- ② A event.

The Organization rented the facility to a theater arts organization to stage their productions (0 days, ranging from 0 to 0 hours/day). In addition to the theater facility, the Organization also provided a combination of sound, lighting and technical technicians. charged \$0 to \$0/day. The invoices only identified the dates the theater would be used, the technicians to be provided and the total fee charged.

Other use of the theater during the June 30, 20XX tax year end was as follows:

- Free use was given to the City of (0 days for meetings; and another day for a luncheon) and to an unrelated arts organization (0 days).
- Free use of the marque was granted on a couple of occasions to publicize the local and a Parks & Recreation recital.

used a booking agent, , DBA Booking Agency (the Agency), to contract the tribute bands appearing at the theater. The Organization entered into a contract with the Agency specifying the band appearance dates and payment. Bands were contracted to perform once a night for one to three nights (Friday through Sunday), with contract fees usually at \$0 per performance. One band did contract for a 0/0 split of ticket sales for their one night performance.

used a ticketing management system and software to sell tickets on its website. Tickets prices ranged from \$0-\$0, with special suite boxes for \$0 (0 tickets provided). staff are used in the theater box office (open 0 hours before performances) and theater operations (theater manager, lighting/sound technicians, bartender).

The Dinner (held September 18-19, 20XX), was identified as a event held as a "community event." ticketing system was used to sell tickets (0 tickets sold at \$0/each). All ticket sales less ticketing fees (\$0) were turned over to . The event was held at the banquet room.

It is indicated that approximately 0 percent of 20XX receipts came from contracted with informally for catering services-no contracts were drawn up. It is indicated that fees were based on the "actual costs of food and related labor for preparation and service." Billing invoices provided for review showed no detail on the services provided other than the event name and the total amount billed

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Law

IRC § 501(c)(3) provides for exemption from Income Tax for corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), 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 (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

IRC § 513(a) defines 'unrelated trade or business' of an exempt organization as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational or other purpose or function constituting the basis for its exemption under section 501.

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

Tax Regs. § 1.501(c)(3)-1(c)(1) of the regulations provides that 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 IRC § 501(c)(3).

Tax Regs. § 1.501(c)(3)-1(d)(1)(ii) states "An organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph 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."

Tax Regs. § 1.501(c)(3)-1(e) states that an organization may meet the requirements of IRC § 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in IRC § 513.

Tax Regs. § 1.513-1(a) provides that gross income of an exempt organization subject to the tax imposed by IRC § 511 is includible in the computation of unrelated business taxable income if:

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- (1) The activity must be a trade or business;
- (2) The trade or business is regularly carried on by the organization; and
- (3) The trade or business is not substantially related to the organization's exempt purpose.

Revenue Ruling 64-174, 1964-1 C.B. 183, states cultural organizations devoted to the promotion of the arts may qualify for exemption under section 501(c)(3) as educational or charitable.

Revenue Ruling 72-369, 1972-2 C.D. 245, states an organization formed to provide managerial and consulting services at cost to unrelated organizations does not qualify for exemption under section 501(c)(3). Provision of services on a regular basis is a trade or business and the provision at cost lacks a donative element to characterize the activity as charitable.

In *Better Business Bureau of Washington, D.C. v. U.S.*, 326 U.S. 279, 283 (1945), the Supreme Court held that the "presence of a single... (nonexempt) purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly... (exempt) purposes."

Government Position

In order for an organization to retain its exempt status under IRC § 501(c)(3) it must demonstrate to the Service that it meets both the organizational and the operational tests per Tax Regs. § 1.501(c)(3)-1(a)(1).

Revenue Ruling 64-174 established that activities promoting the arts can qualify as either charitable or educational for purposes of exemption under IRC 501(c)(3). production of plays/musicals for the public did promote the arts and further IRC 501(c)(3) purposes.

However, ceased producing in-house plays/musicals after 20XX. Board meeting minutes reflect that the decision to cease producing and presenting plays/musicals resulted from the need to reduce operating costs. The Organization estimated overhead costs associated with having the theater open (i.e. utilities, staff) was \$0/day. The production of plays/musicals require many days of cast rehearsals for weeks before the shows. The Organization was concerned with activities being held requiring the theater to be open and no income associated.

Starting in 20XX, the primary activity became the tribute band concerts. used a professional booking agency to contract with bands performing music of well known classic rock bands. The concerts were publicized and tickets were sold to the public on website through a ticketing management system used by . Ticket prices were consistent with tribute band concerts offered by for-profit organizations. staff were used for theater operations during the performances (manager, lighting and sound technicians, bartender).

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Many IRC § 501(c)(3) organizations engage in activities that generate a profit. The existence of profit from an activity does not alone give rise to liability for the tax, or endanger the organization's exemption. Tax Regs. §1.501(c)(3)-1(e) specifically states an organization may qualify under § 501(c)(3) even though it operates a trade or business, even as a substantial part of its activities, if the operation thereof is in furtherance of the organization's exempt purposes, and the organization is not otherwise organized or operated for the primary purpose of carrying on an unrelated trade or business.

The promotion and presentation of professional concerts (tribute bands) through a commercial booking agency is an activity ordinarily carried on by a commercial for-profit entity. Like a for-profit entity, contracted with and paid for the bands to appear, used paid staff to operate the events and sold tickets to the public for prices consistent with similar concerts held by for-profit venues. The concerts were primary activity and regularly carried on. The Organization made a conscious decision to stop producing and presenting plays due to the cost involved. The concerts were specifically held because they "made a profit." As noted in Board minutes, the Organization's greater income from the concerts meant the principal officers (the) could provide a smaller contribution to keep the Organization running.

In this case, the concerts are a substantial commercial activity which does not further any exempt purpose and constitutes the operation of a trade or business per Reg. § 1.513-1(a). Therefore, is like the organization described in *Better Business Bureau of Washington DC*, where the "presence of a single...(nonexempt) purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly...(exempt) purposes."

While the organization let the City use their theater for free (for a couple of days) and provided free marquee advertising to a couple of organizations to publicize their community events, this activity is insubstantial. The only other activity was renting out the theater to an arts organization and a church for their activities. The fees charged largely covered the Organization's expenses incurred for having the theater open (i.e. utilities, staff compensation).

rental activity and provision of support services cannot be said to have an exempt purpose either. not only rented the facility, but also provided lighting, sound and technician services. Per Revenue Ruling 72-369, an organization providing managerial and consulting services to other exempt organizations at cost was not sufficient to characterize the activity as charitable due to the lack of a donative element. Therefore, the rental and services activity could be characterized as commercial and lacking a charitable purpose.

IRC 501(c)(3) organizations must not benefit private interests. Private benefit is indicated on several levels. used exclusively to provide all catering services. Contracts were not executed and invoices issued to only listed the event catered and the total amount due. It was indicated that approximately 0% of business income came from . Also, held a dinner theater event which was publicized by on its theater schedule and used

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ticketing system to sell tickets to the dinner. turned over all ticket receipts less the ticketing system fee incurred to . It does not appear that dealings with were at arms-length. There is insufficient detail to determine if the services were provided at fair market value. Also, business constituted a substantial amount of gross revenues. promoted business activity (dinner theater) and allowed use of its ticketing system for free. It appears that benefited from its dealings with , thereby failing to operate for public purposes under §1.501(c)(3)-1(d)(1)(ii). Also, the decision to only hold tribute band concerts could also be considered private benefit as the funds earned from ticket sales meant less contributions were required from the principal officers (the). is not operated for exempt purposes if net earnings inure in whole or in part to the benefit of private stakeholders or individuals (Tax Regs. § 1.501(c)(3)-1(d)(1)(ii)). The activities described indicate fails to meet the operational test under Regs. §1.501(c)(3)-1(c)(1). is not exempt under IRC 501(c)(3).

Taxpayer Position

The Organization considers the tribute band concerts as fundraising.

The Taxpayer position regarding the Organization revocation is unknown.

Conclusion

As a result of the examination, we have determined that the is not operating for exempt purposes as an IRC 501(c)(3) organization. Accordingly, since failed to operate primarily for exempt purposes, we are proposing revocation of their tax-exempt status, effective July 1, 20XX.

Since the organization will no longer have tax-exempt status beginning July 1, 20XX, they are liable for filing Form 1120, *U.S. Corporation Income Tax Return*, as of that date.