



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
1100 Commerce Street, MS 4920-DAL
Dallas, Texas 75242

Release Number: 200738032
Release Date: 9/21/07

Date: June 28, 2007

UIL: 501.03-01

Org.
Attn: Org.
Org.
Org.

Person to Contact:
Identification Number:
Contact Telephone Number:
In Reply Refer to: TE/GE Review Staff
EIN: N

**LAST DATE FOR FILING A PETITION
WITH THE TAX COURT: Date 2**

Dear :

This is a Final Adverse Determination Letter as to the Org's . exempt status under section 501(c) (3) of the Internal Revenue Code effective Date 1

Our adverse determination was made for the following reasons:

Org has not been operating exclusively for exempt purposes within the meaning of Internal Revenue Code section 501(c) (3). Org also is not a charitable organization within the meaning of Treasury Regulations section 1.501(c) (3)-1(d). You are not an organization which operates exclusively for one or more of the exempt purposes which would qualify it as an exempt organization. You operate substantially for a non-exempt purpose and for private benefit.

Based upon these reasons, we are retroactively revoking your IRC section 501(c) (3) tax exempt status to Date 1.

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. These returns should be filed with the appropriate Service Center for the year ending Date 3 and for all years thereafter.

Processing of income tax returns and assessment 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 in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claim Court or the District Court of the United States for the District of Columbia before the 91st day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment.

You also have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers.

You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling (XXX) XXX-XXXX, or writing to: Internal Revenue Service, Taxpayer Advocates Office, TAO.

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

We will notify the appropriate State Officials of this action, as required by section 6104(c) of the Internal Revenue Code.

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

Sincerely yours,

Marsha Ramirez
Director, EO Examinations

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ISSUE:

Whether the **Org.**, formerly, **Org1** , continues to meet the requirements of Internal Revenue Code section 501(c)(3), and therein continues to qualify for exemption from Federal income tax.

FACTS:

Organizational Documents

The **Org1.** was incorporated as a non-profit corporation under the laws of **State** on **Date 2** , to provide assistance to handicapped and disabled persons in **State**.

Your Articles of Incorporation were amended on **Date 2a**, to state that you are organized exclusively for religious, charitable, scientific, literary, and educational purposes within the meaning of section 501(c)(3) of the Code. Those amendments also limited your powers to those permitted under IRC 501(c)(3) and provided that in the event of dissolution, your assets would be distributed for one or more exempt purposes within the meaning of IRC 501(c)(3).

Articles of Amendment were filed on **Date 2b**, changing the name of the corporation to "**Org.**"

In a letter dated **Date 3**, you were granted exemption under section 501(c)(3) of the Internal Revenue Code as an organization that is not a private foundation because it is described in section 509(a)(2) of the Code. On **Date 3a**, the IRS issued a letter modifying your original exemption letter. That letter indicated that you continued to qualify as an organization exempt under section 501(c)(3) of the Code and that you are an organization that is not a private foundation because you are described in sections 509(a)(1) and 170(b)(1)(A)(vi) of the Code.

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Contracts

On Date 10, Org. doing business as Org. 2, entered into a lease agreement with Dev. Co. for approximately 3,200 square feet of space used as your bingo hall. Name1 is an officer on the Board of Directors for the Org.

The lease was for two years beginning Term and ending Term. The lease excluded the office space located in the bingo hall. The lease agreement called for weekly payments of \$ X,XXX per week.

In the year ended Date1, Name1 was paid \$XX,XXX annual rent for the bingo space which is approximately \$XX.XX per square foot. ($\$XX,XXX / 3,200 \text{ sf} = \XX,XX)

On Date9, Org., doing business as Org 2, entered into a lease agreement with Dev. Co for approximately 600 square feet of space used as offices for the bingo. Name1 is an officer on the Board of Directors for the Org.

The lease was for two years beginning Term and ending Term. The lease agreement called for weekly payments of \$XXX per week.

In the year ended DATE1, Name1 was paid \$XX,XXX for rent for the office space used by the bingo which is approximately \$XX.XX per square foot. ($\$X,XXX / 600 \text{ sf} = \XX,XX)

In the year ended Date11, you paid Name1 \$XX,XXX for rent of the bingo hall. This is approximately \$XX.XX per square foot. ($\$XX,XXX / 3,200 \text{ sf} = \XX,XX)

In the year ended Date 11, you paid Name1 \$XX,XXX for rent of the bingo office space. This is approximately \$XX.XX per square foot. ($\$XX,XXX / 600 \text{ sf} = \XX,XX)

An appraisal as to the fair market rental value of the rental space was obtained from an IRS engineer. The engineer did not differentiate between the bingo space and office space. His appraisal indicated that, in an arms length transaction, the property would normally rent for about \$8. per square foot.

Because the organization paid the property taxes and insurance for the building, which is not normally paid for by the tenant, the appraiser indicated that at least \$1.50 should be subtracted from the fair market square footage rate of \$8.00 to arrive at an adjusted rate of \$6.50 per square foot. The appraiser also indicated that the annual fair market value for equipment rent should be \$3,500.

Using the fair market rental rate of \$6.50 per square foot plus the \$3,500 estimated fair market rental value of the equipment and furnishings, the total fair market value for rent should have been \$28,200. ($3,200 \text{ sf.} + 600 \text{ sf.} = 3,800 \text{ sf.} \times \$6.50 = \$24,700 + \$3,500 = \$28,200$)

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NAME1 received a total of \$XXX,XXX (\$XX,XXX + \$XX,XXX) for rent for the year ended DATE1. Therefore, the total rent received exceeded the fair market rental value by \$XX,XXX. (\$XXX,XXX - \$28,200 = \$XX,XXX)

In the year ended DATE11, NAME1 received a total of \$XX,XXX for rent. (\$XX,XXX + \$XX,XXX) Therefore, in the year ended DATE11, the total rent received exceeded the fair market rental value by \$ (XXX,XXX - \$28,200 = \$XX,XX)

NAME1 indicated in various interviews that the rent was reasonable to him and that it was high because the rent included all equipment and furnishings, utilities and cleaning. He stated that it is like renting a motel room where everything is provided including the maid service.

However, a review of the expenses indicated that the organization paid all expenses including the insurance, property tax, maintenance, cleaning and utilities. The books also showed that the organization paid for replacing the bingo calling equipment, some VCRs, and TV monitors used in the bingo hall.

NAME1 stated in his initial interview, that "before I became a licensed promoter, the only way I could take any money out was for rent since unlicensed promoters are not supposed to be paid." "The rent included all equipment and furnishings, utilities and cleaning. It is like renting a motel room where everything is provided including the maid service."

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Compensation

Even though NAME1 indicated that the rent was high because he provided everything and that he was not supposed to be paid when he was an unlicensed promoter, he received compensation. NAME1 also stated in that interview that: "I was an unlicensed promoter prior to May 2001 and became a licensed promoter in Jan. 2004."

NAME1 received compensation in the amount of \$XX,XXX for the year ended for DATE1. You indicated on your Form 990 for the year ended DATE1, that NAME1 worked 10 hours per week. That equates to an annual salary of \$252,000 for a normal 40 hour work week.

You indicated on your Form 990 for the year ended for DATE11, that you paid NAME1 \$XX,XXX in compensation and that he worked 10 hours per week.

Beginning in December DATE11, you began paying NAME1 12% of the gross bingo income which amounted to a total of \$XX,XXX.XX for promoter's fees paid in the year ended DATE11. The additional payments were made to NAME1 even though the contract was not effective until DATE12.

All total, NAME1 received \$XX,XXX (\$XX,XXX + \$XX,XXX) in compensation for the year ended for DATE11. That equates to an annual salary of \$341,116 for a normal 40 hour work week.

NAME1 indicated in a follow-up interview that: "I put in approximately 30-40 hours per week to manage the organization. I am like a CEO of the organization as someone responsible for all of the daily activities of ORG, now ORG2. I have to look into the validity of exempt organizations that we support. About 98% of the time we give only to organizations exempt under IRC 501(c)(3)."

NAME1 also stated that: "There are no written contracts. The amount of compensation is based on what I figure it is worth for me to do what I do. Promoters usually get a percentage of the business. I am like an entrepreneur that goes out and takes risks and does what it takes to get the job done."

"I pretty much was the man that instigated policy and ran the games. I was the general manager of the bingo. It is hard to distinguish between the bingo activities and the charity's activities. They sort of intertwine with the charity."

NAME1 also stated that: "Without giving a precise answer, I would say the amount of time devoted to the charity's activities and the bingo activities is about 50/50. I have not kept a record of the amount of time devoted to each of the activities."

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On DATE12, you entered into a promoter's contract between the ORG , Inc. (Sponsor and Licensee) and NAME1 (Promoter). The contract has an expiration date of DATE12, and will be automatically renewed for one (1) year terms thereafter, beginning on DATE13.

In accordance with provisions under paragraph 2,a-j of the contract, NAME1 is responsible for supervising and directing the general operations of the "business"; managing the day-by-day operations of the bingo; for employing such individuals as may be required to staff and manage the bingo; for providing and maintaining all bingo equipment and furnishings; for insuring the payment of all bills including bingo paper, payroll expenses, payroll taxes and any other taxes, utilities, maintenance and insurance; and for preparing and filing all bingo reports, paper inventory, State and Federal employer forms; and for furnishing accounting summaries to enable the organization to report the income and net profits from special events on line 9 of Part I of Form 990.

The contract provides that: the "Promoter shall receive Twelve Percent (12%) of the gross revenue (all revenue prior to player payouts) of the bingo on a monthly basis as his compensation for operating and promoting the bingo. All expenses shall then be paid from the bingo account. Any surplus funds after all expenses are paid shall be paid to the Licensee on a monthly basis, with a guaranteed minimum to the Licensee of Five Hundred Dollars (\$500). The reasonableness and sufficiency of said compensation is hereby acknowledged by the parties hereto in consideration for the agreement of the parties. All payments shall be made no later than the tenth (10th) of the month for the preceding month. Promoter shall receive any and all income from the sale of tangible items such as concession items, snacks, dabbers, etc."

During the same time that NAME1 was being highly compensated to promote and manage the day-to-day operation of the bingo games, you were paying Mrs. NAME2 and her husband Mr. NAME3 for managing the bingo games.

In the year ended DATE1, you paid Mrs. NAME2 to manage the bingo games and her husband, Mr. NAME3 was paid and additional \$XX,XXX. to assist her.

In the year ended DATE12, you paid Mrs. NAME2 \$XX,XXX to manage the bingo games and her husband, Mr. NAME3 was paid and additional \$XX,XXX to assist her.

Additionally, Mrs NAME2 was paid \$X,XXX.XX in management fees in accordance agreement entered into on DATE13. The additional payments were made to Mrs. NAME2 even though the contract was not effective until DATE12. Under the terms of the contract between ORG and NAME2 and NAME3, (collectively referred to as "Managers"), Mrs. and Mr. NAMES2&3 are to be paid 7% of the gross bingo sales plus 5% of the weekly net profit as compensation for their services.

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Exempt Activity Time vs. Bingo Time

During our examination we requested documentation showing the amount of time devoted to your exempt activities and to your bingo activities for the year ended **DATE1**. In various interviews with **NAME1**, he indicated that no actual records were kept of the hours devoted to your exempt activities.

The only records made available showing the existence of any exempt activities were the minutes to your board meetings. Those meetings were held infrequently and normally lasted less than an hour.

You indicated on your Form 990 for the year ended **DATE1**, that **Mr. NAME1** worked 10 hours per week. Your Form 990 also showed that **Ms. NAME2**, your bingo manager, worked 40 hours per week.

NAME4, your President, indicated in the initial interview that you had 14 bingo employees give or take one. Your bingo records indicated that you averaged 14.5 bingo employees during the year.

NAME1 stated in the initial interview that the average employee worked 40 hours or less a week. **Mr. NAME1** indicated in that interview that the bingo opened around 3 PM and closed around 12 AM. He also indicated that some bingo employees came in around 12-1 PM to prepare for the bingo games and that normally we do not stay more than an hour for cleanup after we close.

Given the fact that your bingo games are normally open 9 hours a day and allowing 1 hour for setup and cleanup, the average that bingo employees work each day has been conservatively estimated to be 10 hours. The average number of bingo employees working each day has been conservatively estimated at 6 employees per session. The bingo manager's and promoter's time has been based on the number of hours worked per week as shown on your Form 990.

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The amount of time devoted to your exempt activities and the amount of time devoted to your bingo activities for the year ended DATE1, has been calculated as follows:

$$\text{Exempt Function Time} + \text{Bingo Time} = \text{Total Time}$$

$$9.25^a + 24,200^b = 24,209.25$$

$$\frac{\text{Bingo Time}}{\text{Total Time}} = \frac{24,200}{24,209.25} = 99.9\%$$

The percentage of time devoted to your bingo activities for the year ended DATE11, has been computed as follows:

$$\text{Exempt Function Time} + \text{Bingo Time} = \text{Total Time}$$

$$22^c + 24,380^d = 24,402$$

$$\frac{\text{Bingo Time}}{\text{Total Time}} = \frac{24,380}{24,402} = 99.9\%$$

(Exhibits are not included in Redaction Copy As they Are Analysis of figures used in report)

- ^a See Exhibit A
- ^b See Exhibit B
- ^c See Exhibit C
- ^d See Exhibit D

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Gross Exempt Function Income vs. Gross Bingo Income

Our examination showed that you did not receive any gross income from exempt function activities and that you received gross income of \$X,XXX,XXX from your bingo games for the year ended DATE1.

Gross bingo income constituted 100% of your total gross income for the year ended DATE1.

Records for the bingo account showed that you made contributions in the amount of \$XX,XXX for the year ended DATE1.

The percentage of gross receipts going to charitable or other IRC 501(c)(3) purposes for the year ended DATE1, is approximately .59%.

Our examination also showed that you did not receive any gross income from exempt function activities and that you received gross income of \$X,XXX,XXX from your bingo games and \$XX,XXX from bingo dabber sales for the year ended DATE1. Total gross revenue from bingo activities totaled \$X,XXX,XXX

Gross income from bingo and bingo dabber sales constituted 100% of your total gross income for the year ended DATE11.

Records for the bingo account showed that you made contributions in the amount of \$X,XXX for the year ended DATE11.. One check in the amount \$X,XXX to DONEE lacked any documentation showing that it was made to a valid organization exempt under IRC 501(c)(3) or that it served a valid charitable purpose. Therefore, the actual amount of charitable contributions for the year ended DATE11, has been determined to be \$X,XXX..

The percentage of gross receipts going to charitable or other IRC 501(c)(3) purposes for the year ended DATE11, is approximately .35%.

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Nonexempt Expenditures

During our examination we found numerous expenditures for renovating a building to start up NAME5

NAME5 expenditures totaled \$8,423.54 for the year ended DATE1. (See Exhibit E for details.) Expenditures for the start up of NAME5 totaled \$21,240.86 for the year ended DATE11. (See Exhibit F for details.)

Such expenditures do not serve charitable or other purposes within section 501(c)(3) of the Internal Revenue Code.

Our examination showed that, for the year ended DATE1, you paid NAME8 (Mr. NAME1'S niece) \$20,900 from ORG bingo account. The examination also showed that you paid Ms. NAME8 10,400 from ORG'S bingo account for the year ended DATE11. These payments were reflected in the books as salary for "charity accountant". (See Exhibits G & H for details.)

In an interview with NAME8, she stated that she did not perform any work for the bingo in STATE where ORG is located. She indicated that she did some work for the bingo near LOCATION1 and that she worked for NAME 1doing all his accounting for all his different companies: NAME6, NAME7. She stated that she helped NAME2 at the bingo sometimes but "Mainly I worked out of the sales model in one of the subdivisions. That is where I sat all the time." She indicated that she kept the books in Quicken and paid contractors that worked at NAME1 subdivisions. NAME8 further stated that she did not do any work for the bingo when she was at the subdivision.

NAME8 also stated that she did not have a time schedule and that she received one check from the bingo for \$ per week for working at both places.

When asked about the name of the bingo where she worked, NAME8 indicated that it was NAME5.

When asked if she had any records of the work she did for the bingo and for NAME1 real estate business, she indicated that NAME1 has it all.

When NAME1 was asked whether his niece, NAME8, worked for his real estate company, NAME1 stated: "No, She helped with the books for the charity. She assisted NAME2 I can't tell you specifically what duties she performed. I don't know the number of hours she worked per week."

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Gross Bingo Receipts Not Deposited

The examination revealed that you routinely flipped figures on your daily bingo records for bingo prize payouts and gross profit and that all gross bingo receipts were not deposited in the bank. **The total amount of funds that were not deposited for DATE1 is approximately \$18,230.** (See Exhibit I for a detailed list of funds that were not deposited for DATE1.)

The total amount of funds that were not deposited decreased in DATE11. If we disregard the small errors and take into account the highlighted months with the larger amounts, **the total funds that were not deposited for DATE11 is approximately \$5,173.** (See Exhibit J for a detailed list of funds that were not deposited for DATE11.)

The total amount of funds that were not deposited for the two years is approximately \$23,403. NAME2, your bingo manager, indicated in her interview that the money was used for cash expenses. However, she failed to furnish any substantiation showing what the money was used for.

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LAW:

Section 501(a) of the Internal Revenue Code exempts from taxation organizations described in subsection (c) or (d) under this subtitle unless such exemption is denied under section 502 or 503.

Section 501(c)(3) of the Code exempts from taxation: "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."

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of organizations organized and operated exclusively for charitable, educational, or scientific purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Treasury Regulation 1.501(c)(3)-(a)(1) provides, in part, 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 purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt."

Section 1.501(c)(3)-1 of the Income Tax Regulations provides:

(c) Operational test--(1) Primary activities. 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.

Section 1.501(c)(3)-1(c)(2) of the Income Tax Regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(c)(3)-1(d) (1)(ii) provides that the burden of proof is on the organization to establish that it is not organized and operated for the benefit of private interests.

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Church in Boston v. Commissioner, 71 T.C. 102, 107 (1978), provides, in part, that the word "exclusively" does not mean "solely" or "without exception." An organization which engages in nonexempt activities can obtain and maintain exempt status so long as such activities are only incidental and insubstantial. (World Family Corp. v. Commissioner, 81 T.C. 958, 963 (1983).) Neither the Internal Revenue Code, the regulations nor the case law provide a general definition of "insubstantial" for purposes of 501(c)(3). This is an issue of fact to be determined under the facts and circumstances of each particular case. (World Family Corp. v. Commissioner, supra at 967.)

In Help The Children, Inc. v. Commissioner 28 TC 1128 (1957), the court held that an organization engaged in fund-raising activities through operation of bingo games and whose actual charitable contributions consisted of contributions to charitable institutions of insubstantial amounts when compared to its gross receipts from operation of bingo games, did not qualify for exemption under section 501(c)(3) of the Code.

Petitioner's fund-raising activities consisted of the operation of bingo games at the Lodge of the Fraternal Order of the Eagles. It also operated a soda bar, and miscellaneous activities. Income from the soda bar and miscellaneous activities was reported on the returns as \$2,843.25 for 1953 and \$3,672.64 for 1954. The gross receipts from the fixed charge or donation for the use of the bingo cards were \$313,802.20 for 1953 and \$306,309.85 for 1954.

Petitioner did not operate any charitable institutions and its actual charitable function consisted of contributions to various individual doctors and institutions. These contributions totaled \$2,880 in 1953 and \$3,873.20 in 1954. Its principal activity was the profitable operation of bingo games on a business or commercial basis. The principal source of gross receipts was from the fixed charge or donation assessed against each player for the use of the bingo cards.

Therefore, the court held that the petitioner failed to establish that it is entitled to a tax-exempt status in the taxable years in question.

In Make a Joyful Noise, Inc. v. Commissioner, 56 TCM 1003 (1989), the court held that operating regularly scheduled bingo games on behalf of other exempt organizations was a trade or business unrelated to the organization's exempt purposes.

In that case, the court concluded that the petitioner failed to carry its burden of proving that its participation in bingo games was an insubstantial part of its activities.

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In P.L.L. Scholarship Fund, v. Commissioner, 82 TC 196 (1984) the Tax Court held that petitioner was not operated exclusively for exempt purposes under the provisions of section 501(c)(3), I.R.C. 1954, and section 1.501(c)(3)-1(c)(1), Income Tax Regs. Therefore, it is not exempt from Federal income tax.

Petitioner was incorporated as a nonprofit corporation 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 a commercial establishment.

The court stated that: "After careful consideration of the entire record, this Court finds that the petitioner has not carried its burden of showing that it was operated exclusively for an exempt purpose under the required standards."

The court further stated that: "Since the record in this case does not show that the petitioner was operated exclusively for exempt purposes, but rather indicates that it benefited private interests, exemption was properly denied."

In People of God Community v. Commissioner, 75 TC 127 (1980), the court held, that part of petitioner's net earnings inured to the benefit of private shareholders or individuals and that petitioner was not exempt as an organization described in section 501(c)(3), of the Internal Revenue Code of 1954.

The court stated that the burden falls upon petitioner to establish the reasonableness of the compensation. The court indicated that by basing compensation upon a percentage of petitioner's gross receipts, apparently subject to no upper limit, a portion of petitioner's earnings was being passed on to an individual.

The court stated that: "The statute specifically denies tax exemption where a portion of net earnings is paid to private shareholders or individuals. We hold here that paying over a portion of gross earnings to those vested with the control of a charitable organization constitutes private inurement as well. All in all, taking a slice off the pot should be no less prohibited than a slice out of net."

Revenue Ruling 69-383, 1969-2 CB 113, (Jan. 01, 1969) provides in part that, under certain circumstances, the use of a method of compensation based upon a percentage of the income of an exempt organization can constitute inurement of net earnings to private individuals. For example, the presence of a percentage compensation agreement will destroy the organization's exemption under section 501(c)(3) of the Code where such arrangement transforms the principal activity of the organization into a joint venture between it and a group of physicians (Lorain Avenue Clinic v. Commissioner, 31 T.C. 141 (1958)), or is merely a device for distributing profits to persons in control (Birmingham Business College v. Commissioner, 276 F. 2d 476 (1960)).

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Revenue Ruling 64-182, 1964-1 (Part 1) C.B. 186, concluded that an organization qualified for exemption under section 501(c)(3) of the Code where it used the proceeds from a business activity to conduct a charitable, program, "commensurate in scope" with its financial resources, of making grants to other charitable organizations. Thus, an organization whose principal activity is operating games of chance may nevertheless qualify for exemption, provided it uses the proceeds of that business activity in a real and substantial charitable program (such as charitable grant making) commensurate in scope with its financial resources, and other wise meets the requirements of exemption.

Christian Echoes National Ministry, Inc. v. United States, 470 F2d 849 (1972), held, in part, that "tax exemption is a privilege, a matter of grace rather than right".

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GOVERNMENT'S POSITION:

Our examination showed that you conduct bingo games to raise funds to support other charitable organizations.

Name1 owns the building used for offices and for conducting the bingo games. He rents the space used for the bingo games and the offices under two separate leases. **Name1** set the amounts of rent based on what he feels is reasonable. **Name 1** is also an officer on the board of directors for the **Org .**, and for the **Org1**.

In the year ended **Date1**, you paid **Name1** **\$XX,XXX** for rent of the bingo hall. This is approximately **\$XX.XX** per square foot. (**\$XX,XXX /X,XXX sf = \$XX.XX**)

In the year ended **Date 1**, you paid **Name 1** **\$XX,XXX** for rent of the bingo office space. This is approximately **\$XX.XX** per square foot. (**\$XX,XXX /600 sf = \$XX.XX**)

In the year ended **Date11**, you paid **Name1** **\$XX,XXX** for rent of the bingo hall. This is approximately **\$XX.XX** per square foot. (**\$XX,XXX /3,200 sf = \$XX.XX**)

In the year ended **Date 11**, you paid **Name 1** **\$XX,XXX** for rent of the bingo office space. This is approximately **\$XX.XX** per square foot. (**\$XX,XXX /600 sf = \$XX.XX**)

An appraisal as to the fair rental value of the space obtained from an IRS Engineer indicated that the fair market rental value of the bingo and office space is \$6.50 per square foot. He also estimated the fair rental value of the equipment to be \$3,500 annually.

Using the fair market rental rate of \$6.50 per square foot plus the \$3,500 estimated fair market rental value of the equipment and furnishings, the total fair market value of rent should have been \$28,200. ($3,200 \text{ sf.} + 600 \text{ sf.} = 3,800 \text{ sf.} \times \$6.50 = \$24,700 + \$3,500 = \$28,200$)

Name1 received a total of **\$XXX,XXX** (**\$XX,XXX + \$XX,XXX**) in rent for the year ended **Date 1**. Therefore, the total rent received exceeded the fair market rental value by **\$XX,XXX**. (**\$XXX,XXX - \$XX,XXX = \$XX,XXX**)

In the year ended **Date 11**, **Name1** received a total of **\$XXX,XXX** in rent. (**\$XX,XXX + \$XX,XXX**) Therefore, in the year ended **Date 11**, the total rent received exceeded the fair market rental value by **\$XX,XXX**. (**\$XXX,XXX - \$XX,XXX = \$XX,XXX**)

Name1 indicated in various interviews that the rent was reasonable to him and that it was high because the rent included all equipment and furnishings, utilities and cleaning. He stated that it is like renting a motel room where everything is provided including the maid service.

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However, a review of the expenses indicated that the organization paid all expenses including the insurance, property tax, maintenance, cleaning and utilities. The books also showed that the organization paid for replacing the bingo calling equipment, some VCRs, and TV monitors used in the bingo hall.

Even though **Name1** indicated that the rent was high because he provided everything and that he was not supposed to be paid when he was an unlicensed promoter, he received compensation.

Name1 received compensation in the amount of **\$XX,XXX** for the year ended for **Date 1**. You indicated on your Form 990 for the year ended **Date 1**, that **Name 1** worked 10 hours per week. That equates to an annual salary of **\$252,000** for a normal 40 hour work week.

You indicated on your Form 990 for the year ended for **Date11** that you paid **Name1 \$XX,XXX** in compensation and that he worked 10 hours per week. Beginning in **Date 5**, you began paying **Name1** 12% of the gross bingo income which amounted to a total of **\$XX,XXX.XX** in promoter's fees paid in the year ended for **Date 11**

Under the contract, **Name1** is paid 12% of the gross bingo proceeds prior to payout of prizes. **Name1** is responsible for conducting the bingo games. He set the terms of the contract and he selects the organizations and determines the amount distributed for charitable purposes. As previously noted, **Name1** is an officer on your board of directors.

All total, **Name1** received **\$XX,XXX (\$XX,XXX+ \$XX,XXX)** in compensation for **Date11**. That equates to an annual salary of **\$341,116** for a normal 40 hour work week.

Information from your minutes to your board meetings and your bingo records showed that approximately 99.9% of your time was devoted to bingo activities in the year ended **Date1**. Similar information from your minutes and bingo records showed that you also devoted approximately 99.9% of your time to bingo activities in the year ended **Date 11**.

The bingo records showed that the bingo grossed **\$X,XXX,XXX** in the year ended **Date1**, and the bingo grossed **\$X,XXX,XXX** in the year ended **Date 11**.

Gross income from your exempt function activities was \$0 for the year ended **Date1**, and gross income from your exempt function activities was \$0 for the year ended **Date11**.

One hundred percent (100%) of your gross income came from your bingo games for the years ended **Date1** and **Date11**.

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Records for the bingo account showed that you made contributions in the amount of \$XX,XXX for the year ended Date1.

The percentage of gross receipts going to charitable or other IRC 501(c)(3) purposes for the year ended Date1, is approximately .59%.

Records for the bingo account showed that you made contributions in the amount of \$X,XXX for the year ended Date11. One check in the amount \$X,XXX to Name9 lacked any documentation showing that it was made to a valid organization exempt under IRC 501(c)(3) or that it served a valid charitable purpose. Therefore, the actual amount of charitable contributions for the year ended Date11, has been determined to be \$X,XXX..

The percentage of gross receipts going to charitable or other IRC 501(c)(3) purposes for the year ended Date11, is approximately .35%.

You are operated similar to the organizations described in Make a Joyful Noise v. Commissioner; Help the Children v. Commissioner; and P.L.L. Scholarship Fund, v. Commissioner. Those cases involved organizations engaged primarily in fund raising activities through bingo games. The courts held that neither organization qualified for exemption under section 501(c)(3) of the Internal Revenue Code because they were not operated exclusively for exempt purposes.

During our examination we found numerous expenditures for renovating a building to start up Name5. Name5 expenditures totaled \$8,423.54 for the year ended Date1. Expenditures for the start up of totaled \$21,240.86 for the year ended Date11.

Such expenditures do not serve charitable or other purposes within the meaning of section 501(c)(3) of the Internal Revenue Code.

Our examination also showed that you paid Name8 (Name1 's niece), \$XX,XXX from Org1's bingo account for the year ended Date1, and you paid her \$XX,XXX from Org1's bingo account for the year ended Date11. These payments were reflected in the books as salary for "charity accountant".

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In an interview with Name8, she stated that she did not perform any work for the bingo in Location1 where Org1 is located. She also stated that she did some work for Name5 near Location2 and for Name1's real estate developments near Location3. She indicated that she helped Name2 at the bingo sometimes but that she mainly worked out of the sales model in one of Name1's subdivisions. Name8 further stated that she did not have a time schedule and that she received one check for \$XXX per week for working for Name1's real estate developments and for Name5.

Since the payments to Name8 did not serve any legitimate IRC 501(c)(3) purpose for the benefit of Org. or Org1, they are considered to be for the private benefit of Name1.

The examination revealed that you routinely flipped figures on your daily bingo records for bingo prize payouts and gross profit and that all gross bingo receipts were not deposited in the bank. The total amount of funds that were not deposited for Date1 is approximately \$18,230. The total amount of funds that were not deposited for Date11 is approximately \$5,173. The total amount of funds that were not deposited for the two years is approximately \$23,403.

Name2, your bingo manager, indicated in her interview that the money was used for cash expenses. However, she failed to furnish any substantiation to show that the funds were used for legitimate bingo expenses and/or IRC 501(c)(3) purposes.

Since you were unable to substantiate that the funds were used for legitimate bingo expenses and/or IRC 501(c)(3) purposes, they are considered to have been used for nonexempt purposes for the private benefit of your bingo promoter and bingo managers.

Because a substantial part of your activities is not in furtherance of an exempt purpose, we have determined that you are not operated exclusively for an exempt purpose pursuant to section 501(c)(3) of the Internal Revenue Code and section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations.

We have determined that a substantial amount of income from your bingo operation inured to the private benefit of your bingo promoter and bingo managers.

The percentage method of compensation constitutes inurement of net earnings to private individuals which is strictly prohibited under section 501(c)(3) of the Code. The statute specifically denies tax exemption where a portion of net earnings is paid to private shareholders or individuals. (See People of God Community v. Commissioner).

In addition, by engaging in substantial activities that serve private rather than public interests, you are not operated exclusively for one or more exempt purposes pursuant to section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations. (See Church in Boston v. Commissioner and World Family Corp. v. Commissioner.)

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The amount of income distributed from the bingo account for charitable and other IRC 501(c)(3) purposes in the years ended **Date1** and **Date11**, was **\$XX,XXX** and **\$X,XXX**, respectively. The percentage of gross bingo income distributed for charitable purposes was approximately .59% for the year ended **Date1**, and approximately .35% for the year ended **Date11**.

Based on the amount of gross bingo income that was distributed for charitable purposes, we have concluded that the amount of the proceeds received from your bingo activities to conduct charitable and educational programs is not "commensurate in scope" with the financial resources of your bingo operation. (See Revenue Ruling 64-182, 1964-1 (Part 1) C.B. 186)

TAXPAYER'S POSITION:

Name1, your promoter and officer, indicated that **Org.**, formerly, **Org1** was formed to give bingo profits to other IRC 501(c)(3) organizations worthy of support. He indicated in various interviews that he is like an entrepreneur that goes out and takes risks and does what it takes to get the job done and that the amounts of rent and compensation are reasonable. He also indicated that promoters usually get a percentage of the business and that he charges the same amount to run the games as the Department of Revenue (DOR) does to tax the games.

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CONCLUSION:

Based on the analysis of your activities and the sources and amounts of your gross income and expenses, we have determined that you no longer meet the requirements for exemption under section 501(c)(3) of the Internal Revenue Code.

You are operated similar to the organizations described in Make a Joyful Noise v. Commissioner; Help the Children v. Commissioner; and P.L.L. Scholarship Fund, v. Commissioner. Those cases involved organizations engaged primarily in fund raising activities through bingo games. The courts held that neither organization qualified for exemption under section 501(c)(3) of the Internal Revenue Code because they were not operated exclusively for exempt purposes.

Based on the amount of gross bingo income that was distributed for charitable purposes, we have concluded that the amount of the proceeds received from your bingo activities to conduct charitable and educational programs is not "commensurate in scope" with the financial resources of your bingo operation. (See Revenue Ruling 64-182, 1964-1 (Part 1) C.B. 186)

Because a substantial part of your activities is not in furtherance of an exempt purpose, we have determined that you are not operated exclusively for an exempt purpose pursuant to section 501(c)(3) of the Internal Revenue Code and section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations.

We have determined that a substantial amount of income from your bingo operation inured to the private benefit of your bingo promoter and bingo managers.

The percentage method of compensation constitutes inurement of net earnings to private individuals which is strictly prohibited under section 501(c)(3) of the Code. The statute specifically denies tax exemption where a portion of net earnings is paid to private shareholders or individuals. (See People of God Community v. Commissioner).

We have determined that you paid a substantial amount of income for building renovations to start up **Name5** and for salary payments to **Name8** for helping start up **Name5** and for working at **Name1's** real estate developments.

Since the payments did not serve any IRC 501(c)(3) purpose for the benefit of **Org.**, formerly **Org1**, they are considered to be for the private benefit of **Name1**.

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We also determined that you failed to deposit approximately \$23,403 of gross bingo proceeds in the bank account for the **Org.**, formerly, **Org1**, for the two years ended **Date1** and **Date 11**.

Since you were unable to substantiate that the funds were used for legitimate bingo expenses and/or IRC 501(c)(3) purposes, they are considered to have been used for nonexempt purposes for the private benefit of your bingo promoter and bingo managers.

By engaging in substantial activities that serve private rather than public interests, you are not operated exclusively for one or more exempt purposes pursuant to section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations. (See Church in Boston v. Commissioner and World Family Corp. v. Commissioner.)

Based on the facts, law and conclusions cited above, we have determined that you no longer qualify for exemption under section 501(c)(3) of the Internal Revenue Code.

Therefore, your exemption under section 501(c)(3) of the Internal Revenue Code is revoked effective **Date14**, the first day of the year that we determined that you are not operated exclusively for exempt purposes.

Contributions made to you after **Date 14**, are not deductible under section 170 of the Internal Revenue Code.

You are required to file Forms 1120 and pay Federal income tax for all years beginning after **Date 14**.



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service

March 5, 2007

Org.
Org.
Org.
Org.
Org.
Org.

Taxpayer Identification Number:

N

Form:

990

Tax Year(s) Ended:

Date 1 and Date 2

Person to Contact/ID Number:

EO Examiner

Contact Numbers:

Telephone: XXX-XXX-XXX

Fax: XXX-XXX-XXX

Certified Mail - Return Receipt Requested

Dear :

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

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

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

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

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

Letter 3618 (04-2002)
Catalog Number 34809F

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

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

Taxpayer Advocate

TAO

TAO

Phone:XXX-XXX-XXX

FAX: XXX-XXX-XXX

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez
Director, EO Examinations

Enclosures:

Publication 892

Publication 3498

Report of Examination