



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
Attn: Mandatory Review, MC 4920 DAL
1100 Commerce Street
Dallas, Texas 75242

501-08-00

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

LEGEND

ORG = Organization name XX = Date Address = address

Number: **201104045**
Release Date: 1/28/2011

Date: November 5, 2010
Employer Identification Number:
Person to Contact/ID Number:
Contact Numbers:

ORG
ADDRESS

Dear _____ :

In a determination letter dated November 20XX you were held to be exempt from Federal income tax under IRC § 501(c)(8).

We have determined that you have not operated in accordance with the provisions of IRC §501(c)(8). We have explained the basis for our determination in the enclosed report of examination.

On April 14, 20XX, you signed Form 6018-A, Consent to Proposed Action, agreeing to the revocation of your exempt status under section 501(c)(8) of the Code. Therefore, your exemption from Federal income tax is revoked effective January 1, 20XX.

You have filed taxable returns on Forms 1120, U.S. Corporation Income Tax Return, for the years ended December 31, 20XX, 20XX, 20XX and 20XX with us. For future periods, you are required to file Form 1120 with the appropriate service center indicated in the instructions for the return.

This is a final adverse determination letter with regard to your status under IRC § 501(c)(8).

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

Sincerely,

Nanette M. Downing,
Director, EO Examinations

Enclosures:

Report of Examination
Copy of Form 6018-A



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE
TE/GE EO Examinations
400 N. 8th Street, Box 74
Richmond Va 23219

March 19, 2010

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

**ORG
ADDRESS**

**Taxpayer Identification Number:
Form:
Tax Year(s) Ended:
Person to Contact/ID Number:
Contact Numbers:
Telephone:
Fax:**

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear _____ :

We have enclosed a copy of our report of examination explaining why we believe an adjustment of your organization's exempt status is necessary.

If you accept our findings, please sign and return the enclosed Form 6018-A, *Consent to Proposed Action*. We will then send you a final letter modifying or revoking your exempt status.

If we do not hear from you within 30 days from the date of this letter, we will process your case on the basis of the recommendations shown in the report of examination and this letter will become final. In the event of revocation, you will be required to file Federal income tax returns for the tax period(s) shown above. If you have not yet filed these returns, please file them with the examiner as soon as possible, unless a report of income tax liability was issued to you with other instructions. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

If you do not agree with our position, you may appeal your case. The enclosed Publication 3498, *The Examination Process*, explains 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. Please note that Fast Tract Mediation Services referred to in Publication 3498, do not apply to Exempt Organizations.

If you request a conference, we will forward your written statement of protest to the Appeals Office and they will contact you. For your convenience, an envelope is enclosed.

If you and Appeals do not agree on some or all of the issues after your Appeals

conference, or if you do not request an Appeals conference, you may file suit in the United States Tax Court, the United States Court of Federal Claims, or the United States District Court, after satisfying procedural and jurisdictional requirements as described in Publication 3498.

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

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:

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,

Nanette M. Downing
Acting Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Form 6018-A
Report of Examination
Envelope

In lieu of Letter 3610

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG	Tax Identification Number EIN	Year/Period Ended 12/31/20XX

LEGEND

ORG = Organization name XX = Date President = president RA-1, RA-2 & RA-3 = 1ST, 2ND & 3RD RA CO-1 THRU CO-5 = 1ST THRU 5TH COMPANIES BM-1 THRU BM-6 = 1ST THRU 6TH BM

Facts:

The ORG Inc. (hereinafter referred to as ORG) was incorporated under the laws of the state of State on June 13, 20XX.

ORG was recognized as exempt under IRC 501(c)(8) by the Internal Revenue Service in a letter dated December 7, 20XX.

ORG's Form 990 for period ending December 31, 20XX was selected for examination.

President, is President of ORG, and also owns CO-1 and CO-2. CO-1 owns five for-profit establishments called CO-3 which are operationally very similar to ORG (except these establishments are only licensed to operate 5 video lottery terminals, while tax exemption allows ORG to operate 10 video lottery terminals and offer free beverages and snacks). CO-1 loaned a total of \$\$ to ORG to fund initial operations.

ORG leases it's facility from CO-2 for \$\$ per month. CO-2 also has a management agreement with ORG for maintenance and bookkeeping of four video lottery terminals for \$\$ per month.

ORG's Bylaws provide as follows:

Article I. Name

The name of this organization shall be the ORG and each ORG-1 shall be organized as a subordinate ORG-1 of the ORG under the constitution, by virtue of the Charter granted by the CO-3.

Article II. Object

The object of the ORG shall be:

- To promote the social and moral welfare of its members.
- To encourage human and spiritual values of life.
- To cooperate in all charitable and civic appeals....

Article III. Clubs

Section 4. A chartered club shall hold regularly scheduled meetings not less than one (1) each month, on such day and at such place as shall be determined by the Trustees, for transaction of business.

Section 6. A quorum of at least ten members must be present at a meeting in order to transact business.

Article IV. Election of Officers:

Section 1. A chartered club shall hold its annual meeting and election of officers and trustees not

earlier than the first week in November and not later than the second week in December. The officers shall serve for one (1) year or until their successors are duly elected by a plurality vote. The trustees shall serve for the term prescribed in the club bylaws or until their successors are duly elected by plurality vote.

Section 2. The elected officers shall be president, vice president, invocator, secretary, treasurer, warden, sentinel, picket and three trustees.

Article VI. Membership

Section 1. Applicants for membership shall be any person not less than 21 years of age and of good moral character. Application for membership shall be received in writing, signed by the applicant and by a member of the ORG-1 in good standing who recommends the applicant and shall give the applicants name, age, residence, occupation and such other information as the chartered club may prescribe.

Section 2. All applications must be investigated by the Secretary and investigating committee before being balloted on in accordance with the balloting procedures of each chartered club. The initiation fee for membership shall accompany each application.

Section 3. Active members shall maintain regular attendance at meetings and shall actively participate in activities of the ORG-1.

Section 4. Transfer of members from one ORG to another is allowed by transfer card and after having paid a transfer fee to the Chartered club as required and to the Home ORG-1. Transferring member must procure an official membership dues paid receipt stating that member is in good standing from the ORG-1 which transfer is being made.

Section 5. Per Capita Tax: All members shall pay dues annually as set by the Subordinate ORG-1 which includes the per capita tax paid to the CO-3.

Section 6. Initiation: A new member processing fee, i.e. initiation fee, will be charged to each new member to defray administrative costs for both the Subordinate ORG-1 and Home ORG-1.

Section 7. All ORG fees will be set annually by the Supreme Officers of the Home ORG-1 at their July meeting and become effective on the first of January of each year.

The review of the minutes of ORG's meetings showed the following:
Minutes dated December 20XX state "an operational council consisting of BM-1, BM-2, BM-3, BM-4, BM-5, BM-6 and President met for the first time to elect officers." President was nominated and elected unanimously to serve as President. Also elected were BM-4, VP, and BM-3 Recording Secretary. President stated "that the next order of business would be to establish and operate a social club."

Summary of minutes of all other meetings held between 20XX and 20XX:

Meeting Date	# of Persons Attending	Notable business transacted
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02/10/XX	6	CO-1, Inc offered to loan start-up money
03/XX/XX	not stated in minutes	Loan from CO-1 accepted
04/01/XX	4	hired RA-1 on 10/7/XX
10/XX/XX	not stated but 4 named	club opened, motion 2 hire mgnt co.
No date	not stated	RA-2's motions to start quarterly meet
01/XX/XX	not stated but 3 named	need to find new location
07/23/XX	not stated but 2 named	almost paid CO-1 off for monies loaned
01/11/XX	not stated but 2 named	buying pleasant county lodge to fix-up
02/XX/XX	not stated but 2 named	purchased lodge
03/15/XX	3	rehab, CO-1 final pymt., club robbed
11/01/XX	3	new club in old CO-3 bdg. sublease from CO-2 mgnt.
03/01/XX	5	air conditioner not cooling
06/XX/XX	3	roof leak, CO-2 Mgnt to fix.
09/XX/XX	5	discuss planning Christmas party
12/12/XX	no show, 10 inch snow	none
03/XX/XX	2,	donations of \$ and \$ passed
06/XX/XX	6	try again to charter member trip to ft.ball
09/10/XX	4	buy new tractor
12/02/XX	2	donation to PHS girls basketball CO-2m
03/25/XX	3	\$ donation to childrens shelter
06/XX/XX	4	3 scholarships to CO-4
09/XX/XX	2	club must go non-smoking
12/XX/XX	?	RA-3 reports can have separate smoking area with air vents
A small group consisting of President, BM-3 and a few other officers, employees and/or contractors were the only persons ever to attend meetings. No general members were present at any of the meetings held.		

ORG does not follow its own Bylaws in regards to any of the provisions shown above:
 ORG failed to conduct regular monthly meeting, never had a quorum of 10 members at any meeting and never elected the officers and trustees as required and prescribed in its Bylaws.
 ORG failed to require general members to attend meetings or pay dues or initiation fees as required by the Bylaws

Membership is open to anyone and President admitted that no one has ever been refused membership. While members are not allowed guest, anyone may become a member simply by filling out a membership application consisting only of date, name, address, and phone number. ORG failed to ask for occupation as required by Bylaws. (Some membership applications reviewed only contained a date and name.)

ORG does not enforce the Bylaw requirements that new members must be recommended by a current member and investigated by the Secretary or investigation committee.
 Initially there was a one dollar initiation fee charged but the fee was eliminated because patrons

complained that other clubs did not charge anything.

No regular general membership meetings have been held and there were no club activities (other than video lottery gaming) for members to participate in. While minutes of board meeting indicated discussions of activities such as organizing a trip to a football game, President admitted, this activity never actually occurred. Also, members of other ORG-1 are allowed entry without any fee and members do not pay **any** annual dues or initiation fee.

ORG entered an affiliation agreement and paid a charter fee to a parent organization referred to as the "Home ORG-1". ORG could not produce a copy of the affiliation agreement with the Home ORG-1, claiming it was done before the current officers took over. ORG pays the Home ORG-1 a quarterly head tax based on the number of members. However, the parent Home ORG-1 does not supervise ORG, or exercise any control over the activities or operations of ORG.

LAW:

Section 501(c)(8) of the Internal Revenue Code (the Code) provides for the exemption of fraternal beneficiary societies, orders, or associations operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents.

Section 501(c)(10) of the Code provides for the exemption from federal income tax of domestic fraternal societies, orders, or associations operating under the lodge system, the net earnings of which are devoted exclusively to religious, charitable, scientific, literary, educational and fraternal purposes, and which do not provide for the payment of life, sick, accident, or other benefits.

Section 1.501(c)(10)-1 of the Income Tax Regulations (the regulations) provides that an organization will qualify for exemption under section 501(c)(10) of the Code if it is a domestic fraternal beneficiary society, order, or association, described in section 501(c)(8) and the regulations there under, except that it does not provide for the payment of life, sick, accident, or other benefits to its members, and devotes its net earnings exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes.

The leading judicial pronouncement as to what constitutes a "fraternal beneficiary society" is contained in the following extract from National Union v. Marlow, 374 F. 775, 778 (1896):

".... a fraternal-beneficial society ... would be one whose members have adopted the same, or a very similar calling, avocation, or profession or who are working in union to accomplish some worthy object, and who for that reason have banded themselves together as an association or society to aid and assist one another, and to promote the common cause. The term "fraternal" can properly be applied to such an association, for the reason that the pursuit of a common object, calling or profession usually has a tendency to create a brotherly feeling among those who are thus engaged.... Many of these associations make a practice of assisting their sick and disabled members and of extending substantial aid to the families of deceased members. Their work is at the same time of a beneficial and fraternal character, because they aim to improve the condition of a class of persons who are engaged in a common pursuit and to unite them

by a stronger bond of sympathy and interest....”

The National Union did not fit this definition, because it was an association of individuals who were associated for the purpose of obtaining insurance. The court concluded that:

In its practical operations, therefore, the defendant company cultivates fraternity and confers benefits in the same manner that every insurance company doing business on the mutual plan cultivates feelings of fraternity, and confers benefits upon its members. Or, in other words, when the defendant is stripped of all disguises, and judged by the standard of what it is engaged in doing, and what it was most likely organized to do, it is simply an insurance company which carries on an extensive business on the assessment plan.

Central to the concept of fraternal beneficiary societies, whether described in section 501(c)(8) or 501(c)(10) of the Code is the requirement of a fraternal element, a common bond among members. The requirement of a fraternal element is set forth in Philadelphia and Reading Relief Association, 4 B.T.A. 713 (1926).

In that case, an organization composed of railroad employees organized to administer a relief fund for the payment of benefits to its members in case of sickness, accident or death, fell short of this requirement because it lacked the required fraternalistic element. The court noted that the association's membership consisted of individuals whose vocations were as numerous and diverse as the classifications of jobs of a railroad company; that the only motive for the existence of the association was a mercenary one (to provide insurance benefits); that the organization did not have “rituals, ceremonial, and regalia” commonly associated with fraternal associations; and that it was not operated on the lodge system.

In another case, the U.S. Tax Court held that an organization cannot be classified as fraternal when the only common bond between the majority of its members is their membership in that organization. Polish Army Veterans Post 147, 24 T.C. 891 (1955), affirmed as to nonexempt status, 236 F.2d 509 (1956). Only 10 percent of the members had common ties in that they were Polish war veterans or children of such veterans who had served in the armed forces of the Western Alliance. All other dues-paying members were admitted indiscriminately as long as they were elected to membership by a majority vote of members present at any meeting.

The question as to the meaning of “fraternal” was also explored in Wheeler v. Ben Hur Life Ass'n, 264 S.W.2d 289 (1953). The court concluded that the organization was not fraternal.

... The association's constitution and by-laws duly provide for a lodge system, ritualistic form of work, and representative form of government. It has no capital stock and is ostensibly organized solely for the mutual benefit of its members. But actually, while giving superficial attention to these requirements, the Association has been engaged in the life insurance business. The local agent of the Association draws a salary and receives as a commission 50% of the first premium on all insurance policies. He receives a smaller percentage of subsequent premiums . . . The Association's constitution and by-laws provisions relative to ritualistic work are observed only perfunctorily . . . We are convinced from the evidence in this record that the primary function of the Ben Hur Life Association is to sell insurance, and that the Association actually is an insurance company operating under the guise of a fraternal benefit society.

To qualify for recognition of exemption as a fraternal beneficiary organization under section 501(c)(8) or section 501(c)(10) of the Code, an organization must also be operated under the lodge system. Section

1.501(c)(8)-1 of the regulations states that operating under the lodge system means "carrying on its activities under a form of organization that comprises local branches, chartered by a parent organization and largely self-governing, called lodges, chapters, or the like." At a minimum, this requires separate subordinate lodges that operate under the general control and supervision of a parent lodge, and are subject to the laws and edicts of the parent lodge.

In Western Funeral Benefit Association v. Hellmich, 2 F.2d 367, 369 (1924), the District Court for the Eastern District of Missouri defined "lodge system" as follows:

By the "lodge system" is generally understood an organization which holds regular meetings at a designated place, adopts a representative form of government, and performs its work according to a ritual. That does not seem to be a harsh definition of what is usually understood as the lodge system and is not so strict in its requirements as the definitions often stated in the statute books.

Rev. Rul. 73-165, 1973-1 C.B. 224 concerns an organization that was operated under the lodge system, was engaged in conducting fraternal activities, but whose predominant activity was the provision of benefits to its members. The ruling concludes that the organization was described in section 501(c)(8) because there is no requirement that either the fraternal or the insurance features predominate so long as both are present. The ruling is clear, however, that in order for an organization to be described in section 501(c)(8) it must contain substantial fraternal features and conduct substantial fraternal activities. The courts have described fraternal activities as a grouping together of like-minded individuals to accomplish a common purpose. The group must be bound by more than membership in the organization and motivated by purposes other than solely the provision of insurance benefits.

Rev. Rul. 77-258, 1977-2 C.B. 195, provides that a domestic fraternal society operating under the lodge system, which does not provide life, sick, accident, or other benefits, whose members are interested in the use of and philosophy behind a method of attempting to divine the future, and whose net income is used to provide instruction on the use of the method, maintain a reference library, and supply information on the method to the public, qualifies for exemption under section 501(c)(10) of the Code.

RATIONALE:

Fraternal Purposes:

Although there is no definition of fraternal purpose in the Internal Revenue Code, we presume that Congress used the term in the ordinary sense, and according to its legal significance in 1909 when section 501(c)(8) was added. The courts in the cases cited above, were clear in requiring at a minimum that the members of a fraternal organization have a common tie that is more substantial than the desire to purchase insurance or engage in social activities. **"...a fraternal-beneficiary society...would be one whose members have adopted the same, or a very similar calling, avocation, or profession or who are working in union to accomplish some worthy object, and who for that reason have banded themselves together as an association or society to aid and assist one another, and to promote the common cause."** National Union v. Marlow, *supra*. **"An organization cannot be classed as fraternal where the only common bond between the majority of the members is their membership in that organization."** Polish Army Veterans Post 147. Evidence of fraternal activities, such as "rituals, ceremonial, and regalia," helps to establish that an organization has a fraternal purpose. Philadelphia and Reading Relief Association, *supra*. Rev. Rul. 73-165 echoes Congress and the courts in holding that to establish exemption, a fraternal organization must have substantial fraternal features and conduct substantial fraternal activities. **Lastly, we look to substance over form. The fact that an organization's constitution and bylaws may provide for a "lodge system, a ritualistic form of work, and representative form of government" is not enough if actual operations establish a primary**

function that is not fraternal. Wheeler v. Ben Hur Life Association, supra.

ORG does not have substantial fraternal features. ORG's membership is open to anyone over 21. Members are not charged any initiation or membership fee. ORG's bylaws do state that membership applications should contain occupation. However, ORG did enforce that provision and submitted no evidence to establish that its members have a specific "calling, avocation or profession" or a "common tie." Unlike the organization described in Rev. Rul. 77-258, whose members had a single pursuit; ORG's activities do not illustrate how its members have joined together or worked in unison to accomplish any worthy objective. The only common bond among ORG's members appears to be their membership and desire to engage in video lottery.

Further, ORG admitted that it does not follow its own bylaws regarding new or transferred members and initiation and membership fees. The effects of these policies lead us to conclude that ORG is open to the general public in the same manner as a commercial establishment.

Nor has ORG submitted evidence that its listed members have actually participated in substantial fraternal activities. ORG's operation of the Club and conduct of gaming is not inherently a fraternal or a charitable activity. ORG's charter and bylaws do not provide for rituals, ceremonials or regalia commonly associated with fraternal associations. ORG has had no member meetings other than those described above. Nor has ORG engaged in any member activities in furtherance of its' stated objectives. Accordingly, ORG is not operated for fraternal purposes.

Lodge System:

An organization is "operating under the lodge system" if it operates under the general control and supervision of a parent lodge, and is subject to the laws and edicts of the parent lodge. It is generally understood that such an organization holds regular meetings at a designated place, adopts a representative form of government, and performs its work according to a ritual. The courts look to substance over form. Wheeler v. Ben Hur Life Association, supra. A similar result was reached in Western Funeral Benefit Association v. Hellmich, supra.

ORG could not produce a signed copy of any affiliation agreement with its parent Home ORG-1. ORG admitted that the Home ORG-1 does not exercise any control over its activities or operations. This is contrary to the requirement that a parent control and supervise separate, independent, subordinate lodges that are operating under the lodge system. We cannot conclude, on the basis of this record, that ORG is properly chartered and under the general control and supervision of a parent lodge.

Further, ORG has had only one meeting since 20XX at which it elected officers. Since then, there have been no meeting attended by the general membership and no elections have been held. Since ORG is totally controlled by its founder and does not follow its bylaws as to member input, we cannot conclude that ORG has a representative form of government.

In addition, since ORG has held neither general membership meetings nor commenced fraternal activities, we cannot conclude that ORG performs its work according to a ritual. Accordingly, ORG is not operated under the lodge system.

Conclusion:

The results of the examination show that ORG, Inc failed to establish that it is operated as a domestic fraternal society, order, or association. ORG, Inc is not operated under the lodge system as required, and thus does not meet the organizational or operational requirements for exemption under IRC 501(c)(8) or

any other code section. Therefore, we are proposing revocation the organization's exempt status under IRC 501(c) (8) effective January 1, 20XX.