



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
Internal Revenue Service  
400 North 8th Street Room 480 Box 74  
Richmond, VA 23219

December 3, 2009

Number: **201108040**  
Release Date: 2/25/2011

ORG  
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

UIL: 501.08-00

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 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.

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 United States Tax Court, the United States Court of Federal Claims, or 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 Organization 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.

If you accept our findings, please sign and return the enclosed Form 6018-A, *Consent to Proposed Adverse Action*. We will then send you a final letter modifying or revoking 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 that event, you will be required to file Federal income tax returns for the tax period(s) shown above. File these returns with the Ogden Service Center within 60 days from the date of this letter, unless a request for an extension of time is granted. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

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,

Sunita Lough  
Director, EO Examinations

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

Form <b>886-A</b>	U.S. Treasury Department-Internal Revenue Service <b>EXPLANATION OF ITEMS</b>	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 20XX06

**LEGEND**

ORG = Organization name      XX = Date      Address = address      City = city  
 President = president      Treasurer = treasurer      Secretary = secretary  
 RA-1, RA-2 & RA-3 = 1<sup>st</sup>, 2<sup>nd</sup> & 3<sup>rd</sup> RA      CO-1, CO-2, CO-3 & CO-4 = 1<sup>st</sup>, 2<sup>nd</sup>,  
 3<sup>rd</sup> & 4<sup>th</sup> COMPANIES

**ISSUE:**

1. Does ORG satisfy the operational test for a tax exempt organization per IRC Section 501(a) as described in IRC 501(c)(8)?
2. Did ORG comply with the requirements of IRC 6001 and 6003?

**FACTS:**

The ORG (ORG) provided documents to show they obtained their membership charter with the parent organization, the CO-1, on July 26, 20XX. The initial charter showed the organization had the required 25 members in order to become a subordinate organization under the CO-1 and received exempt status under IRC 501(a) as described in IRC 501(c)(8) as a fraternal organization.

The initial charter also shows Treasurer, as a founding member.

Upon arrival for the on-site examination, the agent met with the Treasurer and President (President of organization), at the location of the club to conduct the initial interview. There were no books or records provided for the agent to review at the time as the Treasurer and the President of the organization stated the organization had just completed a move and all the books and records were in a box "somewhere" amongst items to be unpacked located in a separate room. The agent remained on site for two days waiting for records which were never produced.

During site examination and initial interview of the ORG, the following information was revealed and provided by the Treasurer, Treasurer, for the examination of the 20XX06 tax year for which no Forms 990 or 990T were filed:

1. The organization was originally formed to provide members training in leadership and civic consciousness to better their usefulness as citizens. It was also established to provide civic service through the organized efforts of the people in the community, to promote the welfare of the community and its citizens through active, constructive projects. The Treasurer stated the organization provided donations to youth leagues for sports during the first two years of its operations. However, all records were in a box that had not yet been unpacked due to his office recently being moved.

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2. Upon being granted its tax exempt status in 20XX, the organization, in July 20XX was granted a video lottery license as a retailer of 10 machines from the State Lottery Commission at the club's location.
3. Since 20XX the organization's membership has declined and as of the date of this examination, the organization has had no meetings. There were not enough members to form a quorum.
4. The organization had allowed RA-1 (former President of organization) to use the organization's headquarters to operate a private club named "CO-2" which was incorporated as a for-profit LLC. This use of the facility included use of the organization's Gaming and ABC license. RA-1 employed RA-2 & RA-3 to operate the bar and oversee the use of the video poker gaming machines under his LLC. In turn, RA-1 was responsible for paying expense for the use of the club (i.e. utilities, property taxes).
5. All income from the bar and video poker gaming were collected through RA-1's LLC. The LLC made payments to the State Lottery Commission for regulatory obligations. Payments were also made to CO-3 for lease of their 10 video gaming machines. All remaining proceeds were used by RA-1 to pay for conducting his business operations.
6. Treasurer stated the current President, President, is being allowed the same facility use arrangement as was RA-1, in hopes of bringing new members into the organization. Based on this arrangement it would appear that the President of this organization is the individual who is in charge of the bar and gaming operations.
7. Treasurer (the organization's Treasurer), is also being allowed to operate his for-profit Income Tax preparation business, "CO-4", from space being provided at the organization's headquarters.
8. The Treasurer has stated that due to the organization's sharp decline in membership and lack of participation, the organization has not engaged in community civic activities since 20XX.
9. Non-members are allowed access to the facility on a regular basis and are required to pay for their drinks.
10. Non-members are also allowed to use the video gaming machines. In addition, non-members are invited to join the organization however; membership in the organization is not required in order for them to continue patronize.
11. There were no separate records for member and non-member income.

Inspection of organization's facility located at Address, showed the following:

1. There was an outside sign on a roll -a-way post. On one side of the sign facing north the sign read "Public Welcome". On the opposite side of the sign facing south it read "No Membership". Another sign located above the roll-a-way read, "Income Tax". There was no signage on the outside or inside to identify the location as the meeting place of the ORG.

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2. There was a meeting room in the rear of the facility that included a conference table, several chairs a speaker's podium and a framed copy of the ORG charter received from the CO-1 ORG placed on the wall.
3. The current President, President, was present at the facility during the initial visitation. He introduced the current bar manager (who was hired in April of 20XX) as his employee.
4. The facility has 10 video lottery machines which are set up to have video feed directly to the State Lottery Commission.
5. There is a dance room and restrooms.

Based on appearance, the facility is predominantly designed and set up as a bar with video lottery machines.

The Organization failed to respond to the following IDR request:

<u>Document Request</u>	<u>Date issued</u>
A. Form 4564 – Information Document Request #2	09/30/20XX
B. Form 4564 – Information Document Request #3	08/10/20XX

Therefore, the agent was unable to establish any exempt activities for 20XX.

Telephone follow ups were made to Treasurer, on the following dates:

- a. 8/1/20XX    b. 8/25/20XX    c. 9/9/20XX    d. 9/16/20XX

Treasurer returned our call on 9/16/20XX. He stated that he would get information to agent within 5 days. Agent sent third copy of requested information to Treasurer allowing a 15 day response due date of August 24, 20XX, for information to be forwarded. There has been no response received.

After numerous attempts to get information from the organization the agent contacted the CO-1 of the ORG and spoke with Secretary, who is the Financial Secretary of the CO-1 of the ORG. Secretary stated the organization has been delinquent in sending in their quarterly financial statements along with their per capita dues for all active members. Not until July 25<sup>th</sup>, 20XX did the organization send in a payment for per capita dues to cover 12/31/20XX-06/30/20XX in the amount of \$\$\$. The organization failed to submit the detailed reporting to the CO-1 which would state report regular meeting information for each quarter, the names and addresses of its current officers, a financial summary of total receipts and expenses, and membership summary. The last such report that was received by the CO-1 was dated 11/26/20XX. As of October 3, 20XX, the CO-1 has notified the organization it was behind in its per capita dues for 5 quarters.

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**LAW:**

**IRC SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC. 501(c)(8)** Fraternal beneficiary societies, orders, or associations — **501(c)(8)(A)** operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and **501(c)(8)(B)** providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents.

**REGS, §1.501(c)(8)-1. Fraternal beneficiary societies §1.501(c)(8)-1. Fraternal beneficiary societies**

(a) A fraternal beneficiary society is exempt from tax only if operated under the "lodge system" or for the exclusive benefit of the members so operating. "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. In order to be exempt it is also necessary that the society have an established system for the payment to its members or their dependents of life, sick, accident, or other benefits.

Internal Revenue Code Section 6001, Notice or regulations requiring records, statements, and special returns, states in part: Every person liable for any tax imposed by this title, or for the collection thereof, shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe. Whenever in the judgment of the Secretary it is necessary, he may require any person, by notice served upon such person or by regulations, to make such returns, render such statements, or keep such records, as the Secretary deems sufficient to show whether or not such person is liable for tax under this title.

Section 1.6001-1(c) of the Regulations provides, in part, that organizations exempt from tax under section 501(a) shall "keep such books and records as are required to substantiate the information required by" section 6033.

Section 6033 provides, in general, that every organization exempt under section 501(a) shall file an annual return, stating specifically the items or' gross income, receipts, and disbursements, and such other information for the purpose of carrying out the internal revenue laws as the Secretary may by forms or Regulations prescribe, and shall keep such records, render under oath such statements, make such other returns, and comply with such rules and Regulations as the Secretary may from time to time prescribe.

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Section 1.6033-2(i) (2) of the Regulations provides, in part, that every organization which is exempt from tax, whether or not it is required to file an annual information return, shall submit such additional information as may be required by the Internal Revenue Service for the purpose of inquiring into its exempt status and administering the provisions of subchapter F, chapter 1 of subtitle A of the Code, section 6033, and chapter 42 of subtitle D of the Code. Failure to comply with such request for information could result in the loss of your tax-exempt status

Code section 7602, Examination of Books and Witnesses, states in part the following: For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary is authorized- (1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry.

Tax Court of the United States.  
**FRATERNAL ORDER OF CIVITANS OF AMERICA, FORMERLY NORTH AKRON  
CIVITAN CLUB, PETITIONER,**  
v.  
**COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.**

Docket No. 27314.  
Promulgated November 14, 1952.

Lawrence R. Bloomenthal, Esq., and A. H. Ganger, Esq., for the petitioner.

Charles R. Hembree, Esq., for the respondent.

**EXEMPTION- SECTION 101(3)- FRATERNAL BENEFICIARY ORDER- OPERATING UNDER THE LODGE SYSTEM- BENEFIT PAYMENTS TO MEMBERS OF THEIR DEPENDENTS.-** An organization having a membership which lacks a common bond, carrying on no activities which further its written purposes or promote a common object, associating with no other similar organization or 'parent organization' and providing death benefits to any named beneficiary of only one class of members is not a fraternal beneficiary order operating under the lodge system and providing benefits to members or their dependents within the meaning of section 101(3) of the Internal Revenue Code.

The petitioner rented quarters in which it conducted its activities at all times material hereto. It changed the location of its quarters several times. It opened a bar for the first time on December 27, 1944, under a recently obtained liquor license. The record does



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not show how many members there were prior to that time. 571 beneficiary members and 39 social members paid dues to the petitioner for 1945, and 864 beneficiary members and 45 social members paid dues to the petitioner for 1946. The dues during those years were \$3 for beneficiary members and \$1.50 for social members. The petitioner, in addition to the dues, had receipts from the bar, turkey raffles, and the sale of food, including fish fries and clam bakes.

The record does not show just what the activities of the petitioner were during the taxable years but those shown relate principally to improvements of club house and bar facilities and to the creation of a national organization. Previously new members had been initiated in accordance with a ritual. Initiation was postponed in the early part of 1945 due to the large number of new members. There were initiations later but the record does not show when they took place. The record does not show that the petitioner carried on any charitable or civic activities during the taxable years.

The petitioner decided on December 10, 1944, to have a death benefit fund from which to make payments to the designated beneficiaries of deceased members. The plan had been suggested previously but had never been put into operation. The record does not show the terms and conditions of the plan adopted at that time. Three death benefits of \$100 each were paid in 1945 and four in 1946.

OPINION.

MURDOCK, Judge:

The petitioner contends that it was exempt from taxation for the years 1945 and 1946 under section 101(3) of the Internal Revenue Code which provides for the exemption of:

Fraternal beneficiary societies, orders, or associations, (A) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system; and (B) providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents.

The early history and meaning of this same provision in the Revenue Act of 1918 was discussed, with citations of and quotations from decided cases, in Philadelphia & Reading Relief Association, 4 B.T.A. 713, pp. 724-726. The general principles stated therein are applicable here. Cf. Words and Phrases, Permanent Edition, beginning at p. 514. The members of the petitioner had nothing in common, so far as this record shows, except that they were members of the petitioner and it is difficult to detect the fraternal bond required by the statute. It does not appear what, if anything, was ever done by the petitioner to accomplish any of the purposes set forth in its constitutions and by-laws. The petitioner was a beneficial society in the sense that its beneficial members could name beneficiaries who would be entitled to death benefits if the

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member died. The social members were not entitled to such benefits. No civic or charitable activities of the petitioner during the taxable years have been shown.

Section 29.101(3)-1 of Regulations 111 provides 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.' A similar regulation has been in effect since 1918 and should now have the force of law. The petitioner during the taxable years, at least until some time in the latter part of 1946, was not 'operating under the lodge system' as that phrase is defined in the regulations in that the petitioner was the only organization of its kind in existence and the record does not show that there was any 'parent organization' separate from the petitioner. (B), quoted above, would mean little if satisfied by a lodge which provides for the payment of death benefits to the beneficiaries named by one class of members regardless of whether those named are dependents and which provides for the payment of no benefits to another class of members.

The petitioner has failed to show that it was exempt under section 101(3). It does not claim exemption under any other provision. It offered no evidence to show that its failure to file returns was due to reasonable cause and not to willful neglect, does not state that there is an issue as to the additions under section 291, but merely concludes its brief by stating that no penalty is due because the officers sincerely believed it to be exempt and 'the evidence clearly shows that their belief was well founded.' The record does not justify a finding that the failure to file returns was due to reasonable cause and not to willful neglect.

Decision will be entered under Rule 50.

**GOVERNMENT'S POSITION:**

An examination of the ORG activities for tax year ending 20XX06 revealed the following;

1. The audit procedures performed showed that ORG activities are contrary to what it stated in its tax exempt application in the following issues;

- Organization failed to establish any activities under section 501(c)(8) were being conducted by the organization since 20XX.
- Organization allows its ABC license and its Gaming License to be used by for-profit organizations run by its past and current Presidents.
- Organization failed to establish there were any genuine members with common calling, common bond or a vocation as required by IRC 501(c) (8), as mentioned above.

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ORG failed to operate the video lottery machine facility strictly for the benefit of its members as required by State Gaming Laws.

2. ORG failed to provide requested documents during the examination of the F990 return. It not only failed to establish that it engaged in tax exempt activity but also failed to satisfy the requirements of IRC 6001 and IRC Reg. section 1.6033-2(i)(2).

**TAXPAYER'S POSITION:**

During examination of the return, organization stated that it is a fraternal lodge established for members to socialize at the club.

**CONCLUSION:**

ORG failed to establish a genuine membership with common calling, common bond or avocation existed as required by IRC 501(c)(8) while allowing its facility to conduct gaming activities that were open to the general public and thus violating the State gaming laws and its exempt status criteria.

A determination is therefore made that the organization failed to operate as a lodge system as required by IRC 501(c)(8) as supported by the court case of *Fraternal Order of Civitans of America v. C.I.R.* 19 T.C. 240 Tax Court 1952. November 14, 1952

Additionally, the organization's failure to provide requested documents and information to establish tax exempt activity is not in conformity with the requirements of IRC 6001 and IRC Reg. section 1.6033-2(i)(2).

The above findings warrants the proposal to revoke ORG tax exemption per IRC section 501(a) as described per IRC section 501(c)(8) for a fraternal organization effective 7/1/20XX as the beginning of their tax year. Upon revocation of ORG's tax exempt status, it will be required to file form 1120 return as a for profit entity.