



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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

501.07-00

Number: **201146022**
Release Date: 11/18/2011

Date: **August 24, 2011**

LEGEND

ORG - Organization name

XX - Date Address - address

ORG
ADDRESS

Employer Identification Number:
Person to contact/ID Number:
Contact numbers:
Voice:
Fax:

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear :

In a determination letter dated July 31, 19XX, you were held to be exempt from Federal income tax under section 501(c)(7) of the Internal Revenue Code (the Code).

Based on recent information received, we have determined you have not operated in accordance with the provisions of section 501(c)(7) of the Code. Accordingly, your exemption from Federal income tax is revoked effective January 1, 20XX. This is a final adverse determination letter with regard to your status under section 501(c)(7) of the Code.

We previously provided you a report of examination explaining why we believe revocation of your exempt status is necessary. At that time, we informed you of your right to contact the Taxpayer Advocate, as well as your appeal rights. On September 23, 20XX, you signed Form 6018-A, *Consent to Proposed Action*, agreeing to the revocation of your exempt status under section 501(c)(7) of the Code.

You have filed taxable returns on Forms 1120, U.S. Corporate Income Tax Return, for the years ended December 31, 20XX, December 31, 20XX, and December 31, 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.

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 contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely,

Nanette M. Downing
Director, EO Examinations

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX, 20XX & 20XX

LEGEND

ORG - Organization name XX - Date Address - address City - city
 State - state EIN - EIN CO-1, CO-2, CO-3 & CO-4 - 1ST, 2ND, 3RD & 4TH
 COMPANIES

DISCUSSION DRAFT

ISSUES

Whether an organization may continue to qualify for exemption under IRC Section 501(c)(7) when its non-member income consistently exceeds the fifteen percent limitation of total income?

Whether an organization may continue to qualify for exemption under IRC Section 501(c)(7) when its sources of income are from conducting bingo activities with the general public, sales of ink markers, food and drinks to the general public, and rental of its facilities to the general public? And when the source of income is from donations from the general public?

Whether an organization may continue to qualify for exemption under IRC Section 501(c)(7) when it fails to correctly file Form 990-EZ and fails to file Form 990-T when due as required under IRC Section 6033?

Whether an organization no longer exempt under Section 501(c)(7) is liable for filing Form 1120?

Whether the organization is liable for penalties for failure to file tax returns (Form 990-T) under IRC Section 6651?

Whether the organization is liable for penalties for substantial underpayment of taxes under IRC Section 6662?

If revocation is not upheld, whether income to an IRC Section 501(c)(7) organization is taxable as unrelated business income when it is from conducting bingo activities with the general public, sales of ink markers, food and drinks to the general public and when it is from rental of its facilities to the general public? And when it is from donations from the general public?

FACTS

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX, 20XX & 20XX

The ORG (ORG) was incorporated as a State Non-Stock Corporation on December 13, 19XX according a copy of a certification by the Clerk of the Commission dated February 24, 19XX. ORG was granted exemption as an IRC Section 501(c)(7) organization on July 31, 19XX. Review of the State State Corporation website indicated that ORG is an active State Non-stock Corporation with a status date of May 5, 19XX; the original certificate was issued December 13, 19XX.

A copy of ORG's Articles of Incorporation were requested, but was not furnished by the organization.

ORG's constitution and by-laws (revised March 20XX), which is an operating document, sets forth its general purposes as follows:

The ORG's objectives are to operate a civic fraternal organization, to promote the social, literary and benevolent interests of its members, to acquire and own real estate and personal property by gift, devise, or purchase, to conduct dances and socials, and to promote the welfare and civic needs of others.

ORG's constitution and by-laws (revised March 20XX) defines the composition of and terms of service for its board of directors and officers as follows:

A board of directors consisting of seven members shall be elected for staggered terms of one year, two years and three years. The Board of Directors is the official elected body that directs or supervises some activities and control or govern the affairs of the ORG.

All officers are elected for a term of one year. The President and all officers shall succeed themselves in office as long as it is the desire of the ORG.

The Service conducted an examination of ORG for the years ending December 31, 20XX, December 31, 20XX and December 31, 20XX. The examination resulted from an examination of a related IRC Section 501(c)(3) organization, CO-1 (CO-1).

ORG did not file a Form 990, Return of Organization Exempt from Income Tax for the year ending December 31, 20XX under its EIN of EIN. Rather, a Form 990 was filed under the EIN EIN, belonging to CO-1 (CO-1), a related Section 501(c)(3) organization. The consolidated Form 990 combined sources of income and expense from both ORG (Section 501(c)(7) activities) and CO-1 (Section 501(c)(3) activities) for the year ending December 31, 20XX.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX, 20XX & 20XX

ORG filed Form 990EZ for the years ending December 31, 20XX and December 31, 20XX utilizing its own EIN of EIN.

ORG did not file Form 990-T for the years ending December 31, 20XX, December 31, 20XX or December 31, 20XX.

Audit work showed that both ORG and CO-1 are governed by the same board of directors and officers for each of the years under examination. The very same individuals that serve as President and Treasurer for ORG also serve as President and Treasurer for CO-1. The board of directors for ORG serves as the board of directors for CO-1. Neither organization has a conflict of interest policy.

The President of ORG/CO-1 stated that ORG owns the building, land and improvements located at Address, City, State. The building was constructed by members during the late 1950's and early 1960's, per testimony from the President. The building consists of a "private area" with a flat screen television, booths, tables, chairs and a bar with bar stools. Restrooms are located at one end, the street side, and a hallway to a kitchen and private office, utilized by ORG officers, are at the other end. An open doorway leads to a large, open hall with long tables and chairs, bingo calling board and flat screen televisions make up about 70% of the square footage of the building. On the opposite end of the large hall from the street are storage areas and restrooms. A secured room holds the inventory of bingo sheets and sealed cards with sheets on top of each item, indicating current counts and inventory values of the gaming supplies.

According to testimony from the President of ORG/CO-1, the IRC Section 501(c)(7)'s activities conducted by ORG include operation of a bar and kitchen for the use of its members and their guests, Friday night socials, dances and other social activities, rental of the hall to the general public for baby showers, dances, reunions, parties, repasses, etc. ORG conducts fund raising activities such as raffles among the members, car shows and sales of doughnuts to the general public. ORG receives annual donations from CO-2, as well occasionally from other organizations and individuals. ORG sells food, drinks and ink markers to participants of bingo games, operated by the related IRC Section 501(c)(3) organization, CO-1 (CO-1). Revenue from these ORG activities is deposited into the CO-3 Account, number #, which reflects the name of ORG and EIN of EIN and serves as the primary checking account for ORG. The President of ORG/CO-1 has signature authority for this checking account, as does another member of ORG.

Audit work showed that in July 20XX, ORG established a checking account at _____, account number #, which serves as a contingency fund for ORG. Proceeds from fundraising events, as well as a \$\$ donation received in 20XX were deposited into the contingency fund

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX, 20XX & 20XX

during 20XX. The President of ORG/CO-1 has signatory authority for the account as does another member of ORG.

The President of ORG/CO-1 stated that CO-1 conducts its IRC Section 501(c)(3) activities in the building owned by ORG. There is no lease agreement between ORG and CO-1 during the years under examination.

According to testimony by the President of ORG/CO-1, charitable gaming is the primary fund raising activity conducted by CO-1. The IRC 501(c)(3) charitable gaming activities are conducted by the President and Treasurer of ORG/CO-1 and by another member of ORG. Other members of ORG assist with the selling of sealed cards (pull tabs) from time to time. The volunteer bookkeeper assists with counting of the gaming proceeds and preparation of the bank deposit. The President of ORG/CO-1 takes the deposit to the bank. Charitable gaming proceeds are deposited into the CO-4 Checking Account, account number #. ORG's name and EIN were indicated on the CO-4 checking account for the years ending December 31, 20XX and December 31, 20XX. For the year ending December 31, 20XX, the CO-4 checking account was changed to reflect the name and EIN of CO-1. The President of ORG/CO-1 has signature authority for this account, as does another member of ORG.

Commonwealth of State Charitable Gaming Permits indicate that the permit for the time period of November 1, 20XX through October 31, 20XX was in the name of the IRC Section 501(c)(7) organization, ORG. Below is reflected the name of the organization whose name appeared on Charitable Gaming Permits for the indicated periods of time:

<u>Period</u>	<u>Organization</u>
1/1/20XX – 10/31/20XX	CO-1
11/1/20XX – 10/31/20XX	ORG.
11/1/20XX – 12/31/20XX	CO-1

Gaming receipts and direct costs for each of the years under examination as reported on Form 101 to the State Division of Charitable Gaming are reflected below:

<u>Period</u>	<u>Gaming Receipts</u>	<u>Direct Costs</u>
1/1/20XX – 12/31/20XX		
1/1/20XX – 12/31/20XX		
1/1/20XX – 12/31/20XX		

Audit work showed that CO-1 paid for facilities related expenses that were invoiced to ORG from the CO-4 Checking Account; the checks were signed by the President of ORG/CO-1. These

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX, 20XX & 20XX

expenses included cable television and internet, utilities, insurance, real estate and personal property taxes, as well as repairs and maintenance. The table below reflects the facilities related disbursements paid for by CO-1 for the periods ending December 31, 20XX and December 31, 20XX.

<u>Period</u>	<u>Facilities Related Expenses</u>
1/1/20XX – 12/31/20XX	
1/1/20XX – 12/31/20XX	

For the period ending December 31, 20XX, the facilities related expenses of \$ were attributed to ORG. ORG conducted bingo activities and controlled the CO-4 checking account during this time period.

Testimony provided by the President of ORG/CO-1 indicated that ORG sells drinks, food and ink markers to the public during charitable gaming sessions conducted by CO-1. Audit work determined sales and cost of goods sold for each of the years under examination as reflected below:

<u>Period</u>	<u>Sales</u>	<u>Cost of Goods Sold</u>
1/1/20XX – 12/31/20XX		
1/1/20XX – 12/31/20XX		
1/1/20XX – 12/31/20XX		

Audit work showed that ORG rents the building and improvements to the public. Rental income for each of the years under examination is reflected below:

<u>Period</u>	<u>Rental Income</u>
1/1/20XX – 12/31/20XX	
1/1/20XX – 12/31/20XX	
1/1/20XX – 12/31/20XX	

Audit work showed that ORG received donations on an annual basis from individuals and businesses. Donations received from the general public for each of the years under examination are shown below:

<u>Period</u>	<u>Donation Income</u>
1/1/20XX – 12/31/20XX	
1/1/20XX – 12/31/20XX	
1/1/20XX – 12/31/20XX	

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX, 20XX & 20XX

Audit work showed that ORG made deposits into its checking account with CO-3 during 20XX in the amount of \$ and during 20XX in the amount of \$, for which no identification for the source of the funds was provided.

Audit work showed that ORG had fundraising income of \$\$ during 20XX from sales of doughnuts to the general public and incurred \$\$ in direct costs.

Audit work determined that for the Form 990EZ filed by ORG for the year ending December 31, 20XX, income was understated by \$\$\$. Expenses were understated by \$\$\$. Cash in bank was overstated by \$\$\$. Inventory was not reported.

Audit work determined that for the Form 990EZ filed by ORG for the year ending December 31, 20XX, income was understated by \$\$\$. Expenses were understated by \$\$\$. Inventory was not reported.

The President of ORG/CO-1 provided a letter addressed to the Service, dated June 29, 20XX, submitting a plan to address the charitable organization paying a disproportionate amount of the ORG operating expenses. The letter stated the ORG is used 75 percent of the time by the charitable organization. Based on the operating expenses of the past 3 years, the charitable organization will be assessed \$\$ per month for ORG usage effective July 1, 20XX. This letter is attached as Exhibit 1.

The President of ORG/CO-1 provided a letter addressed to the Service, dated August 5, 20XX, which stated the ORG members unanimously voted to terminate its 501(c)(7) tax-exempt status effective October 1, 20XX. The letter is attached as Exhibit 2.

The Chairman of the Board of the ORG provided to the Service a ORG Resolution, dated September 1, 20XX. The Resolution states:

“The Board of Directors of the ORG, Address, City, State, hereby acknowledges the termination of the ORG’s 50(c)(7) tax exempt status as of October 1, 20XX.

Be it resolved, the Board of Directors will work diligently with the ORG’s officers and persons responsible for reports, to ensure that tax reports and pertinent information are submitted in a timely manner.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX, 20XX & 20XX

The Board of Directors further resolves to work toward the goal of regaining the 501(c)(7) tax exempt status by strict compliance with all requirements of the IRS and any other agency involved."

The Resolution is attached as Exhibit 3.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX, 20XX & 20XX

LAW

Section 501(c)(7) of the Internal Revenue Code provides that ORGs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes are exempt from Federal income tax provided no part of the net earnings inures to the benefit of any private shareholder.

Section 6001 of the Code addresses notice or regulations requiring records, statements, and special returns. 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.

Section 6033(a)(1) of the Internal Revenue Code provides, except as provided in IRC Section 6033(a)(2), every organization exempt from tax under section 501(a) shall file an annual return, stating specifically the items of gross income, receipts and disbursements, and such other information for the purposes of carrying out the internal revenue laws as the Secretary may by forms or regulations prescribe, and 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.

Section 6601 of the Code addresses interest on underpayment, nonpayment, or extensions of time for payment, of tax.

(a) General rule. If any amount of tax imposed by this title (whether required to be shown on a return, or to be paid by stamp or by some other method) is not paid on or before the last date prescribed for payment, interest on such amount at the underpayment rate established under section shall be paid for the period from such last date to the date paid.

Section 6651 of the Code addresses failure to file tax return or to pay tax.

(a) Addition to the tax. In case of failure--

(1) to file any return required under authority of subchapter A of chapter 61, there shall be added to the amount required to be shown as tax on such return 5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate;

Section 6662(d)(1)(A) of the Code addresses the imposition of accuracy-related penalty on underpayments of taxes.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX, 20XX & 20XX

(a) If this section applies to any portion of an underpayment of tax required to be shown on a return, there shall be added to the tax an amount equal to 20 percent of the portion of the underpayment to which this section applies.

(d)(1)(A)(i) In general, if there is an understatement of income tax for any taxable year where the understatement exceed 10 percent of the tax required to be shown on the tax return for the taxable year, or

(d)(1)(A)(ii) §§

Public Law 94-568 amended the "exclusive" provision to read "substantially" in order to allow a section 501(c)(7) organization to receive up to 35 percent of its gross receipts, including investment income, from sources outside its membership without losing its tax exempt status. The Committee Reports for Public Law 94-568 further state:

- (a) Within this 35 percent amount, not more than 15 percent of the gross receipts should be derived from the use of a social CLUB's facilities or services by the general public. This means that an exempt social club may receive up to 35 percent of its gross receipts from a combination of investment income and receipts from non-members, so long as the latter do not represent more than 15 percent of total receipts. These percentages supersede those provided in Revenue Procedure 71-17, 1971-1 C.B. 683.

Section 1.501(c)(7) of the Treasury Regulations provides that, in general, the exemption extends to social and recreational clubs which are supported by membership fees, dues, and assessments. However, a ORG otherwise entitled to exemption will not be disqualified merely because it raises revenue from members through the use of club facilities or in connection with club activities.

Section 1.501(c)(7)-1(b) of the Treasury Regulations provides "A club which engages in business, such as making its social and recreational facilities available to the general public . . . is not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, and is not exempt under section 501(a)"

Section 1.6001-1(a) of the Treasury Regulations, in conjunction with Section 1.6001-1(c) of the Treasury Regulations provides that every organization exempt from tax under IRC § 501(a) and subject to the tax imposed by IRC § 511 on its unrelated business income must keep such permanent books or accounts or records, including inventories, as are sufficient to establish the amount of gross income, deduction, credits, or other matters required to be shown by such person in any return of such tax. Such organization shall also keep such books and records as are required to substantiate the information required by IRC § 6033.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX, 20XX & 20XX

Revenue Procedure 71-17, 1971-1 C.B. 683 states use of a club's facilities by the general public is important since it may indicate the existence of a nonexempt purpose or, if not of sufficient substantiality to result in loss of exemption, it may make the club liable for unrelated business income tax.

Revenue Procedure 71-17, 1971—1 C.B. 683, and sets forth the record-keeping requirements for social clubs exempt under IRC section 501(c)(7) with respect to nonmembers use of their facilities. If records are not maintained in accordance with the Revenue Procedure, all receipts may be classified as nonmember income

Revenue Ruling 59-95, 1959-1 C.B. 627, concerns an exempt organization that was requested to produce a financial statement and statement of its operations for a certain year. However, its records were so incomplete that the organization was unable to furnish such statements. The Service held that the failure or inability to file the required information return or otherwise to comply with the provisions of IRC Section 6033 and the regulations which implement it, may result in the termination of the exempt status of an organization previously held exempt, on the grounds that the organization has not established that it is observing the conditions required for the continuation of exempt status.

Revenue Ruling 69-636, 19XX – 2 C.B. 126, demonstrates that when a social club exempt on IRC section 501(c)(7) permits another organization exempt under IRC Section 501(a) to utilize its facilities to raise funds for charity and charges the other exempt organization its direct costs only, the activity will not result in inurement to the club or its members. These charges do not include any pro rata share of overhead expenses or depreciation. These charges will not reimburse the club for any portion of the expenses normally incurred in running the club for members.

Jockey club v. Helvering, 76 F2d 597, 598 (2d Cir 1935) states that "the court in determining whether income derived from nonmembers inured to the benefit of members, held that a club may make a profit on occasion but, taken by and large, the returns from outsiders should do no more than reimburse the club for its costs. However, if upon computation they are such a source of income over a substantial period of time so as to justify the conclusion that it is deliberate, such net earning inure to the benefit of the members, though they are not distributed."

Polish American club, Inc. v. Commissioner, 33 T.C.M. (CCH) 925 (1974) T.C. Memo. 1974-207 held that the statutes and regulations require that exempt social clubs be organized and operated exclusively for pleasure, recreation and other nonprofitable purposes. The case law has modified this requirement by allowing social clubs to qualify for exemption under section

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX, 20XX & 20XX

501(c)(7) when its outside profits were: (1) strictly incidental to club activities, not as a result of an outside business; and (2) either negligible or nonrecurring. However, when the outside income is both substantial and recurring the statutory requirements are not satisfied and the social club is not exempt from tax.

The Minnequa University club v. Commissioner, 30 TCM (CCH) 1305 – Tax Court 1971 held that the "exclusively * * * nonprofitable" operation requirement has been tempered somewhat by regulations and case law. The cases clearly permit generation of some income from nonmember sources so long as the activity generating such income is merely incidental and the income is either negligible or nonrecurring. Where outside income is both substantial and recurring, the statutory requirements are obviously not met and loss of tax-exempt status must result.

United States v. Fort Worth club of Fort Worth, Texas, 345 F. 2d 52 – Court of Appeals, 5th Circuit 1965 states under the taxpayer's construction of section 501(c) (7), it would be "a simple matter to tack a profitable business on to a club that was having difficulty in carrying as large and luxurious a plant as the members might like without the payment of burdensome dues". The Fort Worth club cannot deny it has derived substantial and recurrent profit from a business altogether unrelated to its activities as a social club.

Pittsburgh Press club v. United States, 536 F. 2d 572 – Court of Appeals, 3rd Circuit 1976 It should be noted that tax exemptions are to be strictly construed, and that PPC had an obligation to maintain records adequate to establish a right to the tax exemption it claimed, see I.R.C. § 6001 and Rev. Proc. 71-17. In light of these considerations, the club has the burden of establishing how much of the revenue was attributable to members or nonmembers.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX, 20XX & 20XX

TAXPAYER'S POSITION

The President of club/CO-1 agreed to club's revocation of exemption under Section 501(c)(7) of the Internal Revenue code by signing F6018-A. The President acknowledged the requirement to file income tax returns; he signed and filed Form 1120 for the years ending December 31, 20XX, December 31, 20XX and December 31, 20XX.

The President paid the income tax liabilities on October 7, 20XX related to the Forms 1120 for the years ending December 31, 20XX, December 31, 20XX and December 31, 20XX.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX, 20XX & 20XX

GOVERNMENT'S POSITION

Exemption Issues

In order to determine whether ORG's sources of non-member income exceed the allowed 15%, addressed in Public Law 94-568, the following analysis must be completed.

ORG's sources of member income are as follows:

<u>Period</u>	<u>Member Income</u>	<u>Source</u>
1/1/20XX – 12/31/20XX	<u>\$\$</u>	Dues
1/1/20XX – 12/31/20XX	\$\$	Dues
	\$\$	Initiation Fees
	\$\$	Raffles, Bus Trip
	<u>\$\$</u>	Total for 20XX
1/1/20XX – 12/31/20XX	\$\$	Dues
	\$\$	Initiation Fees
	\$\$	Raffles, Bus Trip
	<u>\$\$</u>	Total for 20XX

ORG's sources of non-member income are as follows:

<u>Period</u>	<u>Non-member Income</u>	<u>Source</u>
1/1/20XX – 12/31/20XX	\$\$	Rent
	\$\$	Donations
	\$\$	Misc. Income
	\$\$	Bar Income
	<u>(\$\$)</u>	Cost of Goods Sold
	<u>\$\$</u>	Total for 20XX
1/1/20XX – 12/31/20XX		Rent
		Donations
		Bar Income
		Cost of Goods Sold
		Misc. Income
		Bingo Receipts

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX, 20XX & 20XX

	Direct Costs
	Building Expenses
	Total for 20XX
1/1/20XX – 12/31/20XX	Rent
	Less Refunds
	Donations
	Doughnut Sales
	Cost of Goods Sold
	Bar Sales
	Cost of Goods Sold
	Total for 20XX

ORG's member and non-member income for each of the three years under examination are summarized below:

<u>Period</u>	<u>Member</u>	<u>Non-member</u>	<u>Non-Member % of Total Income</u>
1/1/20XX – 12/31/20XX			%
1/1/20XX – 12/31/20XX			%
1/1/20XX – 12/31/20XX			%

Under The Minnequa University ORG v. Commissioner, where outside income is both substantial and recurring, the statutory requirements are obviously not met and loss of tax-exempt status must result. This is consistent with the findings of this examination. Because ORG's non-member income is substantial in relation to its other income in all years under examination and recurs in each of the years, the ORG must lose its exemption under Section 501(c)(7) of the Internal Revenue Code.

Public Law 94-568 specifies that an organization exempt under Section 501(c)(7) may not have more than 15% of income from non-member sources. ORG fails the test for the year ending December 31, 20XX where its non-member percentage of total income was 87 percent. ORG fails the test for the year ending December 31, 20XX where its non-member percentage of total income was 95 percent. ORG again failed the test for the year ending December 31, 20XX where its non-member percentage of total income was 91 percent. Because the non-member income for ORG consistently exceeded the 15 percent limitation, ORG is no longer eligible for exemption under IRC Sections 501(a) and 501(c)(7) of the Internal Revenue Code and said exemption should be revoked.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX, 20XX & 20XX

Jockey ORG v. Helvering held that if it turns out upon computation that they are such a source over a substantial enough period to justify the conclusion that this is deliberate, we agree with the Board that the ORG is making earnings which 'inure to the benefit' of the members, though they are not distributed. The finding in Jockey ORG is consistent with the findings in this examination. Inurement to the members occurred during 20XX and 20XX. The members of ORG have during 20XX and 20XX enjoyed the benefit of having the majority of the expenses associated with operating the building they own paid for by CO-1. These payments were from a checking account, where checks were signed by the President of ORG/CO-1. ORG has, for the years under examination, been in control of CO-1 and thereby the incomes derived from CO-1's activities. This is demonstrated by payment of facilities related expenses from CO-1 charitable gaming income. The lack of an independent board of directors and officers has permitted this control. In addition, officers and board of directors which have authority over both ORG and CO-1 have facilitated this control, resulting in inurement to the members of ORG. As a result, ORG's exemption under IRC 501(c)(7) should be revoked.

Revenue Ruling 69-636 provides the framework that ORG could have followed, but chose not to. "When a social ORG exempt on IRC section 501(c)(7) permits another organization exempt under IRC Section 501(a) to utilize its facilities to raise funds for charity and charges the other exempt organization its direct costs only, the activity will not result in inurement to the ORG or its members. These charges do not include any pro rata share of overhead expenses or depreciation. These charges will not reimburse the ORG for any portion of the expenses normally incurred in running the ORG for members." Such was not the case in this examination. CO-1 paid for the majority of all ORG facilities related expenses during 20XX and 20XX. The expenses included utilities, insurance, and taxes, as well as building repairs and grounds maintenance. The President of ORG/CO-1 signed all of the checks when paying these expenses. This is a textbook example of inurement to the members of a Section 501(c)(7) organization, ORG. As a result, ORG's exemption under IRC 501(c)(7) should be revoked.

Section 501(c)(7) of the Internal Revenue Code provides that ORGs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes are exempt from Federal income tax provided no part of the net earnings inures to the benefit of any private shareholder. Inurement to the members has permitted ORG to continue to exist. Without the inurement resulting from the payment of all operating expenses for the building by CO-1 and its charitable gaming activities, ORG would have had to look to the members to pay the operating expenses, which ranged from \$ in 20XX, to \$ in 20XX, and to \$ in 20XX. Member income for 20XX was \$\$, for 20XX it was \$\$ and for 20XX it was \$\$\$. It is unlikely that member income would increase to the level of the building operating expenses. Based upon testimony by the President, the members of the social ORG pay \$ per month as dues and none of the members is willing to pay any more than the current rate of \$ per month. In this instance, ORG

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX, 20XX & 20XX

would need to seek funding from outside of the organization, all of which would lead to the same conclusion. ORG clearly no longer qualifies for exemption under Sections 501(a) and 501(c)(7) of the Internal Revenue Code and said exemption should be revoked.

IRC sections 6001 and 6033 require that all organizations exempt under IRC section 501(a) file a return "stating specifically the items of gross income, receipts and disbursements". ORG did not correctly file Form 990-EZ for the year ending December 31, 20XX. Total income reported on Form 990-EZ was \$. Total income per the examination was \$. Exhibit 5 provides the details of all adjustments made as the result of the examination of the Form 990-EZ for year ending December 31, 20XX. ORG failed to meet the filing requirements of IRC Sections 6001 and 6033 to be recognized as exempt from federal income tax under IRC Section 501(c)(7). As such, said exemption should be revoked.

ORG did not correctly file Form 990-EZ for the year ending December 31, 20XX. Total income reported on Form 990-EZ was \$. Total income per the examination was \$. Exhibit 6 provides the details of all adjustments made as the result of the examination of the Form 990-EZ for the year ending December 21, 20XX. ORG failed to meet the filing requirements of IRC Sections 6001 and 6033 to be recognized as exempt from federal income tax under IRC Section 501(c)(7). ORG is therefore no longer eligible for exemption under Section 501(c)(7) of the Internal Revenue Code.

Treasury Regulations Sections 1.6001-1(a), in conjunction with Section 1.6001-1(c) provide that every organization exempt from tax under IRC Section 501(a) and subject to the tax imposed by IRC Section 511 on its unrelated business income must maintain permanent records such that books and records, including inventories, that are sufficient to establish the amount of gross income, deduction, credits, or other matters required to be shown by such person in any return of such tax. The requirements of IRC Section 6033 must also be met. ORG failed to file when due Form 990-T for the years ending December 31, 20XX, 20XX and 20XX. ORG failed to comply with the filing requirements of Treasury Regulations Sections 1.6001-1(a) and 1.6001-1(c), and IRC Section 6033, which is required to be recognized as exempt under Section 501(c)(7) of the Internal Revenue Code.

ORG failed to file when due Form 990-T for the years ending December 31, 20XX, 20XX and 20XX. ORG failed to correctly file Form 990-EZ for the years ending December 31, 20XX and 20XX. The failure of ORG to file Forms 990-T and correctly file Forms 990-EZ is consistent with the findings in Revenue Ruling 59-95, where the Service held that the failure or inability to file the required information return or otherwise to comply with the provisions of IRC Section 6033 and the regulations which implement it, may result in the termination of the exempt status of an organization previously held exempt, on the grounds that the organization has not

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX, 20XX & 20XX

established that it is observing the conditions required for the continuation of exempt status. ORG has consistently failed to comply with the filing requirements of Sections 6001 and 6033 of the Internal Revenue Code and the Treasury Regulations that implement the Code. As a result ORG's exemption under Section 501(c)(7) of the Internal Revenue Code should be revoked.

Section 6651 of the Internal Revenue Code provides for penalties to be charged for failure to file returns when due. ORG failed to file Form 990-T for years ending December 31, 20XX, 20XX and 20XX. As such ORG is liable for IRC Section 6651 penalties for failure to file for all three years under examination. ORG requested waiver of the penalties under IRC Section 6651 and the Service accepted the request as reasonable cause, giving due consideration to the fact the ORG paid the income tax liabilities for Form 1120 for the years ending December 31, 20XX, December 31, 20XX and December 31, 20XX, as agreed.

Section 6662 of the Internal Revenue Code provides for penalties to be charged for substantial understatement of taxes. The penalties apply when the amount of tax exceeds 10% of the amount tax reported. In this case, ORG failed to file Form 990-T for years ending December 31, 20XX, 20XX and 20XX. No taxes were reported. Therefore ORG is liable for penalties for substantial understatement of taxes for all three years under examination. ORG requested waiver of the penalties under IRC Section 6662 and the Service accepted the request as reasonable cause, giving due consideration to the fact the ORG paid the income tax liabilities for Form 1120 for the years ending December 31, 20XX, December 31, 20XX and December 31, 20XX, as agreed.

ORG has requested termination of its exempt status under IRC Section 501(c)(7) effective October 1, 20XX based upon the unanimous vote of the members. ORG's Board of Directors has issued a board resolution acknowledging termination effective October 1, 20XX. However, ORG has not provided the required documents for the Service to accept the request. The Service requires Articles of Dissolution and a statement attesting to the distribution of the assets. The Service would also require ORG to file Form 990-T for the years ending December 31, 20XX, 20XX and 20XX. ORG must then pay all taxes due. ORG would be required to pay all failure to file penalties under IRC Section 6651 and all substantial understatement of taxes under IRC Section 6662. As ORG has not furnished these documents and the payments have not been made, the Service's position remains unchanged. Proposed revocation of ORG's exempt status under Section 501(c)(7) of the Internal Revenue Code will be pursued.

Attached are Exhibits reflecting income and expenses as reported, adjustments per audit work performed, and income and expenses as adjusted. The exhibits also reflect the income and expenses required to be reported on Form 1120 and the related income tax. Exhibit 4 reports

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX, 20XX & 20XX

information for the Form 990 and Form 1120 for December 31, 20XX. Exhibit 5 reports information for the Form 990EZ and Form 1120 for December 31, 20XX. Exhibit 6 reports information for the Form 990EZ and Form 1120 for December 31, 20XX.

CONCLUSION

ORG no longer qualifies for exemption under Section 501(c)(7) of the Internal Revenue Code, as non-member income consistently exceeded the 15 percent limitation of total income, in all three years under examination. Nonmember income sources consisted of the following activities with the general public: charitable gaming, sales of ink markers, food and drinks, rental of its facilities, and donations from the general public. Hence, revocation of ORG's exemption is proposed effective January 1, 20XX.

It is the Service's position that the organization failed to meet the reporting requirements under IRC Sections 6001 and 6033 to be recognized as exempt from federal income tax under IRC § 501(c)(7). Accordingly, revocation of the organization's exempt status is proposed effective January 1, 20XX.

ORG is liable for filing Form 1120 returns for the tax periods ending December 31, 20XX and all subsequent years.

ORG is liable for penalties under Section 6651 of the Internal Revenue Code for failure to file tax returns when due for all three years under examination.

ORG is liable for penalties under Section 6662 of the Internal Revenue Code for substantial understatement of tax for each of the three years under examination.

ALTERNATIVE POSITION

Unrelated Business Income Issue

ISSUE

If revocation is not upheld, whether income to an IRC Section 501(c)(7) organization is taxable as unrelated business income when it is from conducting bingo activities with the general public, sales of ink markers, food and drinks to the general public and when it is from rental of its facilities to the general public? And when it is from donations from the general public?

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX, 20XX & 20XX

FACTS

According to testimony by the President of ORG/CO-1, charitable gaming is the primary fund raising activity conducted by CO-1. The IRC 501(c)(3) charitable gaming activities are conducted by the President and Treasurer of ORG/CO-1 and by another member of ORG. Other members of ORG assist with the selling of sealed cards (pull tabs) from time to time. The volunteer bookkeeper assists with counting of the gaming proceeds and preparation of the bank deposit. The President of ORG/CO-1 takes the deposit to the bank. Charitable gaming proceeds are deposited into the CO-4 Checking Account, account number#. ORG's name and EIN were indicated on the CO-4 checking account for the years ending December 31, 20XX and December 31, 20XX. For the year ending December 31, 20XX, the CO-4 checking account was changed to reflect the name and EIN of CO-1. The President of ORG/CO-1 has signature authority for this account, as does another member of ORG.

Commonwealth of State Charitable Gaming Permits indicate that the permit for the time period of November 1, 20XX through October 31, 20XX was in the name of the IRC Section 501(c)(7) organization, ORG. Below is reflected the name of the organization whose name appeared on Charitable Gaming Permits for the indicated periods of time:

<u>Period</u>	<u>Organization</u>
1/1/20XX – 10/31/20XX	CO-1
11/1/20XX – 10/31/20XX	ORG.
11/1/20XX – 12/31/20XX	CO-1

Gaming receipts and direct costs for each of the years under examination as reported on Form 101 to the State Division of Charitable Gaming are reflected below:

<u>Period</u>	<u>Gaming Receipts</u>	<u>Direct Costs</u>
1/1/20XX – 12/31/20XX		
1/1/20XX – 12/31/20XX		
1/1/20XX – 12/31/20XX		

Audit work showed that CO-1 paid for facilities related expenses that were invoiced to ORG from the CO-4 Checking Account; the checks were signed by the President of ORG/CO-1. These expenses included cable television and internet, utilities, insurance, real estate and personal property taxes, as well as repairs and maintenance. The table below reflects the facilities related disbursements paid for by CO-1 for the periods indicated.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX, 20XX & 20XX

<u>Period</u>	<u>Facilities Related Expenses</u>
1/1/20XX – 12/31/20XX	
1/1/20XX – 12/31/20XX	

For the period ending December 31, 20XX, the facilities related expenses of \$ were attributed to ORG. ORG conducted bingo activities and controlled the CO-4 checking account during this time period.

Testimony provided by the President of ORG/CO-1 indicated that ORG sells drinks, food and ink markers to the public during charitable gaming sessions conducted by CO-1. Audit work determined sales and cost of goods sold for each of the years under examination as shown below:

<u>Period</u>	<u>Sales</u>	<u>Cost of Goods Sold</u>
1/1/20XX – 12/31/20XX		
1/1/20XX – 12/31/20XX		
1/1/20XX – 12/31/20XX		

Audit work showed that ORG rents the building and improvements to the public. Rental income for each of the years under examination is reflected below:

<u>Period</u>	<u>Rental Income</u>
1/1/20XX – 12/31/20XX	
1/1/20XX – 12/31/20XX	
1/1/20XX – 12/31/20XX	

Audit work showed that ORG receives donations on an annual basis from individuals and businesses. Donations received from the general public for each of the years under examination are shown below:

<u>Period</u>	<u>Donation Income</u>
1/1/20XX – 12/31/20XX	\$\$
1/1/20XX – 12/31/20XX	\$\$
1/1/20XX – 12/31/20XX	\$

Audit work showed that ORG made deposits into its checking account with CO-3 during 20XX in the amount of \$\$ and during 20XX in the amount of \$\$, for which no identification for the source of the funds was provided.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX, 20XX & 20XX

Audit work showed that ORG had fundraising income of \$\$ during 20XX from sales of doughnuts to the general public and incurred \$\$ in direct costs.

LAW

Section 501(c)(7) of the Internal Revenue Code provides that clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes are exempt from Federal income tax provided no part of the net earnings inures to the benefit of any private shareholder.

Section 511 of the Code addresses imposition of tax on unrelated business income of charitable, etc., organizations.

(a) Charitable, etc., organizations taxable at corporation rates.

(2) Organizations subject to tax.

(A) Organizations described in sections 401(a) and 501(c). The tax imposed by paragraph (1) shall apply in the case of any organization described in section 501(c)(1) which is exempt, by reason of section 501(a).

Section 512(a)(3)(A) of the Code defines unrelated business taxable income for social clubs as all gross income that is not exempt function income. Furthermore, it provides that the unrelated taxable income of an organization described in section 501(c)(7) means the gross income (excluding any exempt function income), less the deductions allowed by Chapter 1 of the Code which are directly connected with the production of the gross income (excluding exempt function income).

Section 512(a)(3)(B) of the Code defines exempt function income as "gross income from dues, fees, charges, or similar amounts paid by members of the organization as consideration for providing such members or their dependents or guests goods, facilities, or services in furtherance of the Purposes constituting the basis for the exemption of the organization to which such income is paid."

Section 6001 of the Code addresses notice or regulations requiring records, statements, and special returns. 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.

Section 6033(a)(1) of the Internal Revenue Code provides, except as provided in IRC Section 6033(a)(2), every organization exempt from tax under section 501(a) shall file an annual return, stating specifically the items of gross income, receipts and disbursements, and

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX, 20XX & 20XX

such other information for the purposes of carrying out the internal revenue laws as the Secretary may by forms or regulations prescribe, and 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.

Section 6601 of the Code addresses interest on underpayment, nonpayment, or extensions of time for payment, of tax.

(a) General rule. If any amount of tax imposed by this title (whether required to be shown on a return, or to be paid by stamp or by some other method) is not paid on or before the last date prescribed for payment, interest on such amount at the underpayment rate established under section shall be paid for the period from such last date to the date paid.

Section 6651 of the Code addresses failure to file tax return or to pay tax.

(a) Addition to the tax. In case of failure--

(1) to file any return required under authority of subchapter A of chapter 61, there shall be added to the amount required to be shown as tax on such return 5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate

Section 6662 of the Code addresses the imposition of accuracy-related penalty on underpayments of taxes.

(a) Imposition of penalty. If this section applies to any portion of an underpayment of tax required to be shown on a return, there shall be added to the tax an amount equal to 20 percent of the portion of the underpayment to which this section applies.

(d)(1)(A)(i) In general, if there is an understatement of income tax for any taxable year where the understatement exceed 10 percent of the tax required to be shown on the tax return for the taxable year . . .

Public Law 94-568 amended the "exclusive" provision to read "substantially" in order to allow a section 501(c)(7) organization to receive up to 35 percent of its gross receipts, including investment income, from sources outside its membership without losing its tax exempt status. The Committee Reports for Public Law 94-568 further state:

(b) Within this 35 percent amount, not more than 15 percent of the gross receipts should be derived from the use of a social club's facilities or services by the general public. This means that an exempt social club may receive up to 35 percent of its gross receipts from a combination of investment income and receipts from non-members, so long as

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX, 20XX & 20XX

the latter do not represent more than 15 percent of total receipts. These percentages supersede those provided in Revenue Ruling 71-17, 1971-1 C.B. 683.

Section 1.501(c)(7) of the Income Tax Regulations provides that, in general, the exemption extends to social and recreational clubs which are supported by membership fees, dues, and assessments.

Section 1.501(c)(7)-1(b) of the Regulations provides "A club which engages in business, such as making its social and recreational facilities available to the general public . . . is not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, and is not exempt under section 501(a)"

Revenue Procedure 71-17, 1971-1 C.B. 683 states use of a club's facilities by the general public is important since it may indicate the existence of a nonexempt purpose or, if not of sufficient substantiality to result in loss of exemption, it may make the club liable for unrelated business income tax.

Revenue Procedure 71-17, 1971—1 C.B. 683, and sets forth the record-keeping requirements for social clubs exempt under IRC section 501(c)(7) with respect to nonmembers use of their facilities. If records are not maintained in accordance with the Revenue Procedure, all receipts may be classified as nonmember income

Revenue Ruling 69-636, 19XX – 2 C.B. 126, demonstrates that when a social club exempt on IRC section 501(c)(7) permits another organization exempt under IRC Section 501(a) to utilize its facilities to raise funds for charity and charges the other exempt organization its direct costs only, the activity will not result in inurement to the club or its members. These charges do not include any pro rata share of overhead expenses or depreciation. These charges will not reimburse the club for any portion of the expenses normally incurred in running the club for members.

Pittsburgh Press club v. United States, 536 F. 2d 572 – Court of Appeals, 3rd Circuit 1976
It should be noted that tax exemptions are to be strictly construed, and that PPC had an obligation to maintain records adequate to establish a right to the tax exemption it claimed, see I.R.C. § 6001 and Rev. Proc. 71-17. In light of these considerations, the club has the burden of establishing how much of the revenue was attributable to members or nonmembers.

United States v. Fort Worth club of Fort Worth, Texas, 345 F. 2d 52 – Court of Appeals, 5th Circuit 1965 states under the taxpayer's construction of section 501(c) (7), it would be "a simple matter to tack a profitable business on to a club that was having difficulty in carrying as large and luxurious a plant as the members might like without the payment of burdensome

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX, 20XX & 20XX

dues". The Fort Worth club cannot deny it has derived substantial and recurrent profit from a business altogether unrelated to its activities as a social club.

GOVERNMENT'S POSITION

The State Division of Charitable Gaming issued a charitable gaming permit to ORG for the time period of November 1, 20XX through October 31, 20XX. The CO-4 checking account where the gaming proceeds were deposited carried the name of the ORG and carried the EIN of EIN, belonging to ORG. Officers and members of ORG conducted the charitable gaming activities with the general public. When ORG conducted charitable gaming activities with the general public it violated Section 1.501(c)(7)-1(b) of the Regulations. The income of \$\$ from the public gaming activities is not exempt function income as defined in IRC Sections 512(a)(3)(A) and 512(a)(B) of the Internal Revenue Code in that the income is derived from activities conducted by members with the general public and not from activities conducted by members with members of the ORG. This income is therefore unrelated business income and taxable under IRC Section 511 of the Internal Revenue Code.

ORG sold drinks, food, and ink markers to the general public during charitable gaming activities. ORG also sold these same items to its members and guests. Under Pittsburgh Press club v. United States, and Revenue Procedure 71-17, the ORG has the burden of establishing how much of the revenue was attributable to members or nonmembers. ORG did not furnish records differentiating between sales to members and sales to non-members. As such all sales are deemed to be from non-members and are by definition unrelated business income. ORG is therefore subject to taxation on its unrelated business income under IRC Section 511 of the Internal Revenue Code.

ORG rented its facilities to the general public during each year of the examination. Rental income was \$\$ in 20XX, \$\$ in 20XX and \$ in 20XX. Such rental income is not exempt function income for a Section 501(c)(7) organization as defined in IRC Section 512(a)(3)(B) in that the source of income is not from members. The income is substantial in relation to its other income in 20XX and 20XX and has been ongoing throughout the years under examination. The rental income is therefore taxable as unrelated business income under Section 511 of the Internal Revenue Code.

ORG received donations from the general public for each of the years under examination. Section 512(a)(3)(A) of the Code defines unrelated business taxable income for social ORGs as all gross income that is not exempt function income. Section 512(a)(3)(B) of the Code defines exempt function income as "gross income from dues, fees, charges, or similar amounts paid by members..." In that donations from the public are not paid by members, such income is not exempt function income. The donation income from the general public, and not members, is

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX, 20XX & 20XX

therefore taxable as unrelated business income under Section 511 of the Internal Revenue Code.

The findings under United States v. Fort Worth ORG of Fort Worth, Texas are not unlike what ORG has experienced. The Fort Worth ORG cannot deny it has derived substantial and recurrent profit from a business altogether unrelated to its activities as a social ORG. ORG conducted gaming activities with the public during twelve of the thirty-six months under examination. ORG regularly rents its facilities to the general public. ORG regularly receives donations from the general public. ORG regularly sells food, drinks and ink markers to the general public. Each of these activities resulted in recurrent profit from business altogether unrelated to its activities as a social ORG. As such, the income associated with each of these activities is taxable as unrelated business income under Section 511 of the Internal Revenue Code.

Section 6651(a)(1) of the Internal Revenue Code provides for penalties to be charged for failure to file returns when due. ORG failed to file Form 990-T for years ending December 31, 20XX, 20XX and 20XX. As such ORG is liable for IRC Section 6651 penalties for failure to file for all three years under examination.

Section 6662 of the Internal Revenue Code provides for penalties to be charged for substantial understatement of taxes. The penalties apply when the amount of tax exceeds 10% of the amount tax reported. In this case, ORG failed to file Form 990-T for years ending December 31, 20XX, 20XX and 20XX. No taxes were reported. Therefore ORG is liable for penalties for substantial understatement of taxes for all three years under examination.

Attached are Exhibits reflecting income and expenses as reported, adjustments per audit work performed, and income and expenses as adjusted. The exhibits also reflect the income and expenses required to be reported on Form 990-T and the related income tax. Exhibit 7 reports information for the Form 990 and Form 990-T for December 31, 20XX. Exhibit 8 reports information for the Form 990EZ and Form 990-T for December 31, 20XX. Exhibit 9 reports information for the Form 990EZ and Form 990-T for December 31, 20XX.

CONCLUSION

ORG is liable for unrelated business income on the following activities:

- Gaming activities conducted with the general public
- Sales of food, drinks, and ink markers to the general public
- Rental of the facilities to the general public
- Donation income from the general public

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX, 20XX & 20XX

ORG is liable for filing Form 990-T for the years ending December 31, 20XX, 20XX and 20XX.

ORG is liable for penalties under Section 6651 of the Internal Revenue Code for failure file tax returns when due for all three years under examination.

ORG is liable for penalties under Section 6662 of the Internal Revenue Code for substantial understatement of tax for each of the three years under examination.