



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

501.06-00

Date: September 29, 2011

Release Number: **201203021**
Release Date: 1/20/2012

LEGEND

ORG - Organization name
XX - Date Address - address

Employer Identification Number:
Person to Contact/ID Number:
Contact Numbers:

ORG
ADDRESS

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear

In a determination letter dated January 28, 19XX, you were held to be exempt from Federal income tax under section 501(c)(6) 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)(6) 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)(6) 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 29, 20XX you signed Form 6018-A, *Consent to Proposed Action*, agreeing to the revocation of your exempt status under section 501(c)(6) of the Code.

You are required to file Form 1120 U. S. Corporation Income Tax Return with the Ogden Service Center. You have filed taxable returns on Form 1120 U. S. Corporation Income Tax Return for the years ended December 31, 20XX and December 31, 20XX with us. In addition, 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



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
5990 West Creek Road, Stop 405
Independence, Ohio 44131

**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

February 18, 2011

TIN:

Form
Tax Year Ended

ORG
ADDRESS

Dear

After examining all available information, we believe an adjustment of your organization's exempt status may be necessary. Our proposed adjustment is found in the enclosed Form 4621-A, and a detailed explanation is found in the enclosed Form 886-A.

If you accept our findings, please sign the enclosed Form 6018 consent form and mail it to our office within 10 days from the date of this letter. See enclosed Publication 3498 for details on the examination process and Publications 5 and 892 for details on appeal rights.

If you do not accept our findings, you have 10 days from the date of this letter to mail us any additional evidence or information you would like us to consider. Or you may request a discussion of our findings with an examiner who is familiar with your return, and submit any additional evidence or information you would like the examiner to consider. You may also request a conference to discuss the proposal with the examiner's group manager. If you plan to come in for a discussion, please phone or write us in advance so that we can arrange a convenient time and place.

If we do not hear from you within 10 days, we will have to process your case on the basis of the adjustment shown in the examination report. The person whose name and telephone number appear above will be glad to answer any questions you may have. An addressed envelope is enclosed for your convenience. Thank you for your cooperation.

Sincerely,

Cheryl A. Johnson
Internal Revenue Agent

Enclosures:
Form 4621-A
Form 886-A
Agreement Form 6018
Publications 3498, 5, and 892
Envelope

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	EIN 34-0633860
Name of Taxpayer ORG		Year/Period Ended December 31, 20XX

LEGEND

ORG - Organization name XX - Date City - city State - state
CO-1 & CO-2 = 1st & 2nd COMPANIES

ISSUE

Whether the tax-exempt status of a 501(c)(6) organization whose primary activities are fundraising, coupon redemption, and voucher redemption should be revoked.

FACTS

Purpose

Subject organization is recognized as a section 501(c)(6) tax-exempt organization. According to its Form 1024 application for exempt status, the primary purpose of the organization is "to facilitate the exchange of knowledge and results of experience among persons in the field of grocery food sales and/or management in the City, State area, and to promote the general welfare of the grocery industry." Its principal activities are listed as: discouraging trade abuses; disseminating useful information; monitoring and commenting on legislation for the better protection of the local grocery industry; attending state and national conventions; publishing a weekly newsletter; providing education and public awareness programs and member events; and conducting public awareness campaigns re health and safety issues associated with the grocery industry. The organization's Code of Regulations as revised 11/15/19XX replaced previous "active" and "associate" member categories with one regular member class, defined as "persons active in the grocery industry in the ORG area who pay annual dues. "

Activities

The organization's activities include two annual fundraising events (wine tasting and golf outing), a coupon redemption program (unrelated business income), and a CO-1 voucher exchange program for members. For the year ended December 31, 20XX, the organization's net income by dollar amount is as follows:

Revenue Source	Gross	Expenses	Net
Fundraisers			
Investment			
Coupon UBI			
Member Dues			
Voucher Exchange			

The organization reported a capital loss of \$ and salary/administrative expenses of \$. Total decrease in net assets was (\$.)

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Fundraisers (Wine Tasting and Golf Outing)

The organization states that 96-97% of the participants in the fundraisers held March 6 and July 23 were members, although no sign-in sheets, agenda, or minutes are available. Flyers for the fundraisers indicated that a portion of the proceeds would benefit the Scholarship Fund. No scholarships were awarded by the organization in 20XX.

Coupon Redemption

The organization functions as a local collection agent for coupon redemption for the convenience of its members. Revenue from the coupon redemption program was correctly reported as unrelated business income on Form 990-T. However, the organization could provide no substantiation for the net operating loss carryforward claimed against the income.

CO-1 Voucher Program

The CO-1 provided vouchers to lower income families which could only be redeemed at association member stores. The organization collected and counted the vouchers, obtaining reimbursement from the CO-1 and making payment to the participating stores. Because the stores obtained full reimbursement, this program increased sales for members. It did not benefit the organization financially but provided a service to members.

Member Meetings and Dues

The organization states that member meetings were held at restaurants on November 6 and December 11. The organization states that useful information was discussed at member meetings, with members presenting problems, situations, or concerns of importance to them. Board minutes refer to the November 6 meeting as a membership appreciation party. Financial statements record the December 11 meeting as a Christmas party. No sign-in sheets, agendas, or minutes are available for the member meetings.

Member dues account for 7% of gross revenue. Annual dues during 20XX were paid by only 45 of 140 companies listed on the membership rolls.

Board Meetings

Monthly board meetings document regular discussions of financial statements, status of investments, and fundraising event planning. Board minutes do not document any discussions of topics related to the improvement of the grocery industry.

Time Allocation

Form 990 reports that each of 12 board members spends an average of five hours a week, or 260 hours a year, participating in activities of the organization. The Executive Director spends an average of twenty hours a week, or 1040 hours per year, participating in the activities of the organization. The organization was not able to

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provide a description of the relationship of the hours spent and their relationship to the exempt purpose. The organization does state that 150 hours was spent on the golf outing, 14 hours was spent on the wine tasting, and 60 hours was spent on the CO-1 voucher program.

Information Sharing

The organization states that it provides members with e-mails and faxes received from the State and National CO-2s at least weekly on topics pertaining to the grocery industry. The Executive Director stated during an interview that it is actually the board members who receive the e-mails and faxes and pass them on to members in their groups. Many members also belong to the affiliated State and National associations and receive the alerts directly.

LAW

Section 501(c)(6) of the Internal Revenue Code exempts from federal income tax business leagues, chambers of commerce, real-estate boards, or boards of trade...not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(6)-1 of the Treasury Regulations provides that in order to be exempt as an organization described in section 501(c)(6) of the Code, a business league must possess the following characteristics:

1. It must be an association of persons having some common business interest and its purpose must be to promote this common interest.
2. It must not be organized for profit.
3. No part of its net earnings may inure to the benefit of any private shareholder or individual.
4. ***Its activities must be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons.***
5. ***Its primary activity does not consist of performing particular services for individual persons.***
6. Its purpose must not be to engage in a regular business of a kind ordinarily carried on for profit, even if the business is operated on a cooperative basis or produces only sufficient income to be self-sustaining.

The primary activity for Section 501(c)(6) organizations must be improving business conditions in one or more lines of business. Primary activity is considered greater than fifty percent based on time and income. Exemption may be revoked if the nonexempt activities constitute more than fifty percent. Exemption will not be affected by particular services for members so long as the primary activity is in accordance with the Code.

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Malat v. Riddle, 383 U.S. 569 (1966) and Treas. Reg. 53.4942(b)-1(a) (2) (ii) describe the meaning of "primary" as "of first importance" or "principally."

In Rev. Rul. 70-244, an organization of business and professional persons of a community which provided luncheon and bar facilities for members but had no specific program directed to the improvement of business conditions was held to not be exempt under 501(c)(6.)

In Rev. Rul. 61-170, exemption was denied to a nurse's registry controlled and financed by participating nurses where its activities consisted of assigning nurses to jobs.

In Rev. Rul. 57-453, an organization which promoted the publication of its members writings does not qualify for exemption under 501(c)(6.)

In Rev. Rul. 71-175, an organization that operated a telephone answering service for member doctors does not qualify for exemption under 501(c)(6.)

In Rev. Rul. 76-409, an organization that publishes and distributes to its members, customers and potential customers a directory containing members names and addresses does not qualify for exemption under 501(c)(6.)

In America Automobile Association v. Commissioner, 19 T.C. 1146 (1953), AAA was found not to be exempt as a business league under 501(c)(6) because its principal activities were determined to consist of securing benefits and performing particular services for members.

TAXPAYER'S POSITION

The organization believes that it is entitled to exemption under section 501(c)(6) because the fundraising events and member dinners provide a forum for members to exchange the knowledge and the results of experience in their common area of interest. They believe the alerts that are shared with members serve the purpose of educating members and the public.

GOVERNMENT'S POSITION

Based on the facts of the examination, the organization does not qualify for exemption because its primary activities, as measured by revenue received and time spent, are not related to its 501(c)(6) exempt purpose of improving the retail grocery industry. The organization's primary sources of gross revenue are the voucher exchange program, fundraisers, investments, and coupon redemption. The voucher exchange program provides a service to members by increasing sales and providing a means to redeem

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vouchers at full value from the provider. The fundraisers provide revenue but are open to the public and their exempt purpose activity cannot be substantiated. The coupon redemption program is unrelated business income that is a convenience to members. The organization was not able to provide documentation to show time spent on activities related to its exempt purpose. It did not maintain records of the two member dinner meetings to document exempt purpose. Even if two member meetings and transmission of alerts are counted as exempt purpose activities, they do not rise anywhere near the fifty percent level needed to be considered primary. The organization does not demonstrate a meaningful extent of membership support as measured by membership dues or involvement in the organization's activities.

CONCLUSION

Because the organization's primary activities are not related to its exempt purpose of improving business conditions in the grocery industry, the organization does not qualify for exemption under section 501(c)(6) and its tax exempt status should be revoked effective January 1, 20XX. This organization is required to file forms 1120 for all tax periods beginning after December 31, 20XX.

ALTERNATIVE ISSUE

In the alternative, if the organization qualifies for exemption under section 501(c)(6), should the unrelated business income be reduced by the unsubstantiated net operating loss carryforward as reported on Form 990-T?

FACTS

The organization reported \$ of net unrelated business taxable income on Form 990-T for coupon redemption service in 20XX, which it reduced by \$ of net operating loss carried forward from prior years.

When asked to substantiate the net operating loss deduction, the organization was initially unable to do so, per the response received September 9, 20XX. They were unable to provide the amount or year or business activity involved in the original loss or a schedule of the net loss carryforward claimed on subsequent returns.

The organization claimed net operating loss carryforward to offset all unrelated business income in all years available for research online:

Tax Year	Unrelated business income	Deductions claimed	NOL Deduction Claimed without substantiation	UBI Taxable Income

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20XX				
20XX				
20XX				
20XX				
20XX				

On October 29, 20XX, additional information was provided by the EO in the form of a spreadsheet and copies of Forms 990-T for 19XX-19XX and 20XX-20XX. (Note: Forms 990-T for 20XX-20XX were not included on the spreadsheet and copies were not provided.) EO was unable to provide any details about the method used to allocate expenses to unrelated business income. The following inconsistencies were noted based on a simple examination of percentages when comparing the 990-T to the 990 for the three earliest years - which generated net operating losses - and the three most recent years, which generated positive income. The chart below highlights some of the significant expenses; the complete listing with actual dollar values can be seen on the attached spreadsheet.

UBI revenue or expense/total	19XX	19XX	19XX	20XX	20XX	20XX
Income						
Compensation						
Salaries						
Occupancy						
Auto						
Office Supplies						
Accounting						
Maintenance						
Insurance						

In addition, the following expenses were deducted on the 990-T in the years 19XX-19XX but not shown as expenses on the Form 990:

- Taxes and Licenses
- Excess Read Cost
- Stationary and Postage
- Dues
- Bank Charges

Since the method of allocation used is unknown, it cannot be shown to be reasonable. Because books and records relating to the years generating the net operating loss are not available, revenue agent cannot determine whether the net operating loss is valid or

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assign a reasonable method of allocating expenses. Deduction for an unsubstantiated net operating loss will not be allowed.

LAW

Internal Revenue Code Section 6001 requires that "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."

Treasury Regulation 1.6001-1 states in part that "any person required to file a return of information with respect to income, shall keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by such person in any return of such tax or information."

Internal Revenue Code Section 7602(a) states in part that "For the purpose of ascertaining the correctness of any return... the Secretary is authorized to examine any books, papers, records, or other data which may be relevant or material to such inquiry."

This would include net operating losses carried forward under IRC Section 172 (b.)

TAXPAYER'S POSITION

The taxpayer's written explanation is as follows: "When the 20XX 990-T was filed, there had been a change in accounting firms along with the Executive Director for the CO-2. The only backup documentation available at that time was the 20XX 990-T. There was no schedule attached to that return with a breakdown of the prior years' losses. Therefore it was determined since an NOL can be carried forward for 20 years and the year of incorporation was 19XX, the NOL would be carried forward until the year ended 20XX, at which time the entire amount would no longer be used. Furthermore, we were aware there was a prior audit conducted sometime between 19XX and 20XX, we are unsure of the time as current officers were not involved and documentation has not been located. As a result, we feel there would not have been a NOL carryforward in the tax year 20XX had it been found to be incorrect as a result of that prior audit.'

Note: An IRS audit history check reveals examination of the 1992 Form 990 resulted in an agreed tax change to the 990-T of \$. Before 20XX, the last IRS examination conducted was in 19XX.

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GOVERNMENT'S POSITION

Taxpayers are aware that they must substantiate claims for net operating losses carried forward. Publication 536 states "You must attach a statement that shows all the important facts about the NOL. Your statement should include a computation showing how you figured the NOL deduction." Instructions for preparation of the Form 990-T, line 31, state "Attach a schedule showing the computation of the NOL deduction."

Internal Revenue Manual (hereafter the "IRM") 4.11.11.12 states "the taxpayer is required to maintain such records as will allow the examiner to verify the accuracy of the deduction. If the taxpayer declines to produce the records, or the records are unavailable, the examiner may disallow the entire net operating loss deduction for lack of substantiation. Copies of tax returns are not proof, nor are accountant's workpapers."

CONCLUSION

If the tax exempt status of the organization is not revoked, the unsubstantiated net operating loss carryforward amounts claimed on Forms 990-T for the open years ended 20XX and 20XX are disallowed. The organization failed to substantiate that it ever had a net operating loss, and if it did have a net operating loss, the organization could not show that the loss had not been previously absorbed. No evidence was provide to support this deduction and it is therefore disallowed.