DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

501.04-00

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: 02/13/2013

Number: **201414028**
Release Date: 4/4/2014

LEGEND
ORG - Organization name
XX - Date Address - address

ORG
ADDRESS

Taxpayer Identification Number:
Form:
Tax Year(s) Ended:
Person to Contact/ID Number:
Contact Numbers:
Group Manager Contact Number:

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear :

In a determination letter dated September 15, 19XX, you were held to be exempt from Federal income tax under section 501(c)(4) 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)(4) of the Code. Accordingly, your exemption from Federal income tax is revoked effective January 1, 20XX. This is a final letter with regard to your exempt status.

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 January 28, 20XX, you signed Form 6018-A, Consent to Proposed Action, agreeing to the revocation of your exempt status under section 501(c)(4) of the Code.

You are required to file Federal income tax returns for the for tax period(s) shown above. If you have not yet filed these returns, please file them 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.

Thank you for your cooperation.

Sincerely,

Nanette M. Downing
Director, EO Examinations

Form 886A	Department of the Treasury - Internal Revenue Service **Explanation of Items – Revocation & Tax Assessment**	**Schedule No. or Exhibit** **#1**
Name of Taxpayer **ORG** **Address** **City, State**		**Year/Period Ended** **20XX12, 20XX12, 20XX12**

LEGEND
ORG - Organization name XX - Date Address - address City - city
State - state County - county President - president CO-1 THROUGH
CO-4 - 1ST THROUGH 4TH COMPANIES

ISSUES:

1. Whether an organization can lawfully retain its tax-exempt status under section 501(c)(4) of the Internal Revenue Code (**IRC**) as originally granted in 19XX by the IRS, when it was originally organized as a fire-fighting company, and has since abandoned that purpose and replaced it with a purely social content
2. Whether all income from the activities of an organization, which does not maintain a book-of-accounts or general ledger, and therefore cannot produce a statement of income and expense, and which further engages members of the public-at-large in all revenue activities, and which further induces the public-at-large to consider membership in order to participate in the many social activities, should be includable for tax purposes, and considered the income from a for-profit business as opposed to that of a tax-exempt organization
3. Whether income derived from the cancellation of debt (COD, sometimes referred to as discharge of indebtedness or DOI) on an original loan amount of $ (building improvement loan) is taxable to an organization, where the COD equals $ as asserted by the organization's President

FACTS:

Operating as a social club since 19XX

The examined organization was incorporated in 18XX as a CO-1 and later granted tax-exempt status in 19XX under section 501(c)(4) of the IRC, and was named after the community it was intended to serve, ORG (City).

During an interview with President, the organization's current President, President disclosed that the CO-1 surrendered or transferred all fire-fighting equipment over to the CO-2, which itself, had formed a centralized CO-1. This transfer of equipment and the decision, to no longer continue as a CO-1, took place in December of 19XX. That is, the original purpose of the organization was abandoned in that it purposefully withdrew from any further engagement as a fire-fighting organization.

From that point forward, the members of the organization continued to operate as a social club, thereby providing for the continued socialization of its members, and also continued to set aside a small amount of each member's dues for the purchase of an insurance benefit. At no point did the organization attempt to amend its exempt status with either the City or the Internal Revenue Service (**IRS**).

Instead, it routinely engaged the general public in for-profit transactions as evidenced by paid advertisements for such things as hall-rentals, food and beverage sales, gaming (Adult-toy bingo, Kid's Toy bingo and raffles), and which operated as a social club, offering take-out services to the public as given in the March 20XX minutes. There is no record of the organization reporting income from unrelated business transactions, nor was a 990-T filing requirement ever established.

For the years ending December 31st, 20XX, 20XX, 20XX, 20XX, 20XX and 20XX (six consecutive years), the organization failed to file Form 990. President asserted that at some point in 20XX, the organization realized that it had ignored its filing requirements, possibly in response to media coverage of the automatic revocation of exempt

organizations that failed to file for three consecutive years, and in an attempt to retain its status, filed Form 990-N electronically.

Throughout the interview, President affirmed the preceding statements as fact.
The organization's application to the Court of Common Pleas, County, City, states that the "purpose for which it (ORG) is formed is for the control and extinguishment of fire". This sentiment of purpose is repeated in Article I of the Constitution of the organization with the words "the object of this Company shall be fully recognizing the benefits and advantages to be derived from a well organized body of men in case of fire....to preserve the property of fellow citizens from the ravages of that destructive element, we do hereby form ourselves into an association, to be known as ORG No 2 of the CO-2, City".

While the preceding language exemplifies the conduct of a corporation organized to provide an important social-welfare service, the fighting of fire, and which would normally be found to meet the requirements of IRC section 501(c)(4), it was made clear during the initial interview process that ORG no longer exists to offer such an important benefit to the community. Instead, it operates to provide a social benefit to its members only, as funded by engaging the public in for-profit business transactions which range from various forms of bingo (such as Adult Toy Bingo where the prizes are apparently of an erotic nature as suggested by the names of the vendors, i.e., CO-3 and CO-4) to line dancing (where couples are admitted for a fee), to small games of chance (various raffles). In almost all cases there is evidence of the sale (sometimes take-out sales) of food and beverages (some of which are alcoholic), thereby causing it to function more like a social club (typically exempt under section 501(c)(7) of the IRC). An examination of the check register over a three-year period (20XX, 20XX and 20XX) indicates the purchase of beer and "booze", but during the initial interview President is on record for having stated that "No alcohol is stored on the property".

Cancellation of Debt

Also during the interview and in response to question number 44 President disclosed an amount not previously reported as cancellation of debt, or debt forgiveness, and which amount has never been reported for tax purposes. The question and answer are repeated here:

Question: Because we (IRS) have no filing activity from 20XX to 20XX, what other possible sources of income may have been excluded from the annual reporting process? Consider, for example, the sale of real property on which there may have been a capital gain, or cancellation-of-debt income as may be found from the forgiveness of a loan or other financial obligation.

Answer: "There is about $ cancellation of debt income on a loan of $ from the CO-2."

See electronic work paper 3-D-6.1 (copy of the organization's chronological historical events), which serves as evidence of the origination of the loan.

Consideration of taxable income based on analysis of bank deposits and check registers

During the initial interview it was established that the treasurer of the organization did not maintain sufficient accounting books and records to establish a statement of income or loss (work paper 3-C-1, Conclusion). As such it was necessary to rely on an analysis of deposits and check register entries to establish an estimate of income and allowable expenses, which is shown in the following illustrations.

The sum of all known deposits (including interest earned), as verified against bank statements, was used to estimate total revenue. The final amount was reduced by the amount of transfers between accounts. The agent was able to establish that debt-forgiveness occurred only in the year ending December 31, 20XX.

The sum of all recorded checks, as verified against both the check register and bank statements, and bank fees was used as an estimate of allowable expenses, adjusted according to the following criteria. First, only those entries where an identifiable memo entry was recorded will be considered as allowable; in the absence of a memo entry, the amount was disallowed. Second, all disbursements identified as inventory (food and beverages) was allowed at the rate of seventy-five percent of identifiable costs; this was done to consider an estimate of twenty-five percent as an estimate of remaining inventory, carried forward as tangible assets (items of future economic benefit). Third, all entries that indentified a capital improvement were disallowed under section 263 of the IRC (See LAW).

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Computation of tax

Based on the amounts given in the preceding illustrations, the agent developed a computation of income tax as shown in the next set of illustrations.

When the amounts of tax for the three years under examination are summed, the final amount of income taxes due, before any interest and/or penalties, is **$.**

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LAW:

Applicable Internal Revenue Code Sections

Authority to grant tax-exempt status
IRC section 501(c)(4)(A) – provides, in general, that an organization is tax exempt if it is organized as a civic league, but may not be organized for profit; and further that it be operated exclusively for the promotion of social welfare.

IRC section 501(c)(4)(B) – holds that subparagraph (A) shall not apply to an entity unless no part of the net earnings of such entity inures to the benefit of any private shareholder or individual (this includes the body of members of an organization)

Authority to require an annual return
IRC section 6033(a)(1) – holds, in general that , except as provided in paragraph (3), every organization exempt from taxation 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 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; except that, in the discretion of the Secretary, any organization described in section 401(a) may be relieved from stating in its return any information which is reported in returns filed by the employer which established such organization.

Authority to impose recordkeeping requirements
IRC section 6001 - holds 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.

Authority to impose a tax on corporations
IRC section 11(a) – provides the authority to impose a tax for each taxable year on the taxable income of every corporation. Like the income tax on individuals, the income tax on corporations is gradual. Individuals and corporations have a liability to pay.

IRC section 11(b)(1) – provides, in general that the amount of the tax imposed by subsection (a) shall be the sum of 11(b)(1)(A), 15 percent of so much of the taxable income as does not exceed $50,000,

Authority to revoke exempt status
IRC section 6033(j)(1) In general. — If an organization described in subsection (a)(1) or (i) fails to file an annual return or notice required under either subsection for 3 consecutive years, such organization's status as an organization exempt from tax under section 501(a) shall be considered revoked on and after the date set by the Secretary for the filing of the third annual return or notice. The Secretary shall publish and maintain a list of any organization the status of which is so revoked.

IRC section 6033(j)(2) Application necessary for reinstatement. — Any organization the tax-exempt status of which is revoked under paragraph (1) must apply in order to obtain reinstatement of such status regardless of whether such organization was originally required to make such an application.
Income from whatever source derived

IRC section 61 Gross Income Defined. - Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:
61(a)(1) Compensation for services, including fees, commissions, fringe benefits, and similar items
61(a)(2) Gross income derived from business

Taxable income defined
IRC section 63(a) IN GENERAL. — Except as provided in subsection (b), for purposes of this subtitle, the term "taxable income" means gross income minus the deductions allowed by this chapter

Cancellation of Debt (Discharge of Indebtedness) as taxable income
IRC section 61(a)(12) Income from discharge of indebtedness is includable as taxable income

Allowable expenses which reduce taxable income
IRC section 162. Trade or Business Expenses, In General — There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including (beyond this point the Code applies the basic criteria that most expenses must meet in order to be claimed as trade or business deductions, and details a number of expenses that are automatically disallowed.

Expenses disallowed which are considered capital expenditures
IRC section 263(a) - provides that, generally, taxpayers must capitalize amounts paid to improve tangible property

Applicable Treasury Regulations

Authority regarding record-keeping requirements
Treasury Regulation section1.6001-1(a) – provides in general that, except as provided in paragraph (b) of this section, any person subject to tax under subtitle A of the Code (including a qualified State individual income tax which is treated pursuant to section 6361(a) as if it were imposed by chapter 1 of subtitle A), or 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

Treasury Regulation section1.6001-1(c) - every organization exempt from tax under section 501(a) shall keep such permanent books of account or records, including inventories, as are sufficient to show specifically the items of gross income, receipts and disbursements. Such organizations shall also keep such books and records as are required to substantiate the information required by section 6033. See section 6033 and §§1.6033-1 through -3.

Treasury Regulation section1.6001-1(e) - The books or records required by this section shall be kept at all times available for inspection by authorized internal revenue officers or employees, and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law

Prohibition of social club as the primary activity of a social welfare organization
Treasury Regulation section 1.501(c)(4)-1(a)(2)(ii) – holds that the promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public

office. **Nor is an organization operated primarily for the promotion of social welfare if its primary activity is operating a social club for the benefit, pleasure, or recreation of its members, or is carrying on a business with the general public in a manner similar to organizations which are operated for profit.**

Authority to impose a tax
Treasury Regulation section 1.11-1(a), Every corporation, foreign or domestic, is liable to the tax imposed under section 11 except (1) corporations specifically excepted under such section from such tax: (2) corporations expressly exempt from all taxation under subtitle A of the Code (see section 501); and (3) corporations subject to tax under section 511(a). Note, however, that section 511 deals with the right to impose tax on unrelated business income, which is deemed not to be applicable in the case of an organization that is being considered for revocation. The tax effect is the same under either section 11 or section 511, in that the right to impose the tax is equal.

Cancelled debt is taxable income
Treasury Regulation section 1.61-12 – holds that a taxpayer will realize income if a debt that is owed is cancelled or discharged. In general, the discharge of indebtedness, in whole or in part, may result in the realization of income. If, for example, an individual performs services for a creditor, who in consideration thereof cancels the debt, the debtor realizes income in the amount of the debt as compensation for his services. A taxpayer may realize income by the payment or purchase of his obligations at less than their face value. In general, if a shareholder in a corporation which is indebted to him gratuitously forgives the debt, the transaction amounts to a contribution to the capital of the corporation to the extent of the principal of the debt.

Applicable Revenue Rulings

Retirement benefits, alone, not sufficient to uphold exemption under section 501(c)(4)
Revenue Ruling 81-58 – holds that a nonprofit police officer association, which is primarily engaged in providing retirement benefits to members and death benefits to the beneficiaries of members, does not qualify for exemption from federal income tax under section 501(c)(4) of the Code as a social welfare organization. This ruling cites Revenue Ruling 75-199 with a similar outcome.

Minor or incidental benefit, alone, not sufficient to uphold exemption under section 501(c)(4)
Revenue Ruling 75-199 – In regard to an organization that was formed to provide sick benefits for its members and pay death benefits to the beneficiaries of members, and where membership is restricted to individuals of good moral character and health who belong to a particular ethnic group and reside in a stated geographical area, it was held that since the benefit from the organization in question is for its members and there is only minor and incidental benefit to the community as a whole, the organization does not qualify for exemption from Federal income tax under section 501(c)(4) of the Code.

Dancing & other social events allowable provided that the original exempt purpose is intact
Revenue Ruling 74-361 (Rev. Rul. 66-221 superseded) – An organization whose primary activity is maintaining and operating a volunteer fire department for the benefit of the community is exempt from Federal income tax under section 501(c)(4) of the Internal Revenue Code of 1954 even though the principal source of its income is from operating social facilities for its members and holding regular public dances. (Note, that in the present case, this cannot be used as a remedy to ignore the sales of dance lessons and offering social dancing to members of the general

public, as both rulings observe that this applies only in the case of an organization "whose primary activity is maintaining and operating a volunteer fire department for the benefit of the community". In the present case, such activity has been abandoned, and the date of abandonment is December 19XX.)

Organization's social welfare program is not its primary activity
Revenue Ruling 68-46 – An organization does not qualify for exemption from Federal income tax under section 501(c)(4) of the Internal Revenue Code of 1954 where it is primarily engaged in renting a commercial building and operating a public banquet and meeting hall having bar and dining facilities.

Interpretation of section 501(c)(4) which recognizes the creation of an instrumentality by government to be a remedy to revocation, but only if the government controls the organization, which is not evident in this case
Revenue Ruling 87-126 – holds that a nonprofit firefighters' association (an association of firefighters employed by a community fire department and that was established and maintained by the local government to provide retirement benefits for certain of its firefighters), which is engaged in providing retirement benefits to members, qualifies for exemption from federal income tax under section 501(c)(4) of the Code as a social welfare organization, but only insofar as the organization is under the control of the local government. In the current case this would not serve as a remedy to revocation as the organization is no longer a fire-fighting organization, its purpose is purely social in nature, and there is no intervention or control by government; it is operated by its members.

Applicable Revenue Procedure

Authority to revoke exempt status
Revenue Procedure 20XX-9 - A determination letter or ruling recognizing exemption may not be relied upon if there is a material change, inconsistent with exemption, in the character, the purpose, or the method of operation of the organization, or change in the applicable law. Also, a determination letter or ruling may not be relied upon if it was based on any inaccurate material factual representations. And further: A determination letter or ruling recognizing exemption may be revoked or modified by (1) a notice to the taxpayer to whom the determination letter or ruling was issued

Citable U.S. Tax Court Cases

Engaging in a commercial or for-profit activity:
Los Angeles County Remount Association, Petitioner V. Commissioner of Internal Revenue, Respondent. Docket No. 4555–66 Filed September 23, 1968: The information before (the court) does not show that (the organization) has been carrying out (its exempt) purposes. However, it does show (the organization has) been engaging in (commercial activity). "These activities are conducted in a commercial manner and are not exempt activities within the intendment of Section 501(c)(4) of the Code." As such, the Commissioner of Internal Revenue (Respondent) subsequently revoked petitioner's exempt status, by letter dated April 29, 19XX, with the following explanation: "The information before us does not show that you have been carrying out your stated purposes. However, it does show that you have been engaging in an operation known as the 'Pepper Tree Ranch (a commercial activity).' This activity consists primarily of boarding, rental of four horses owned by you and the collection of fees for the use of your grounds by persons wishing to ride or exercise their own horses. These activities are conducted in a commercial manner and are not exempt activities within the intendment of Section 501(c)(4) of the Code". Decision will be entered for

Respondent (Commissioner of Internal Revenue).

Operating for other than exclusively for the promotion of social welfare

American Women Buyers Club, Inc., Plaintiff-Appellant v. United States of America, Defendant-Appellee , Exempt organizations: Civic leagues: Women buyers club(Nov. 25, 1964), U.S. Court of Appeals, Second Circuit, (Nov. 25, 1964): The court found that a membership corporation open to and consisting of women who were buyers of ready-to-wear accessories or related lines did not qualify as a tax-exempt civic organization (under section 501(c)(4) of the IRC) operated exclusively for the promotion of social welfare, since the corporation performed many services for its members and, therefore, was not operated exclusively for the promotion of social welfare. (And further) "The word 'exclusively' as used in the statute has not been given a strict interpretation, so as to foreclose every operation for a non-exempt purpose no matter how insubstantial, but rather has been interpreted to mean 'primarily.' Debs Memorial Radio Fund, Inc. v. Commissioner, [45-1 USTC ¶9258] 148 F. 2d 948, 952 (2 Cir. 1945)]; . . . Stated another way, 'the presence of a single . . . [non-exempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes.' Better Business Bureau v. United States, 326 U. S. 279, 283 (1945)." Affirmed U. S. Court of Appeals, 2nd Circuit, No. 28798, 338 F2d 526, 11/25/64, Affirming District Court, 64-1 USTC

TAXPAYER'S POSITION:

The examining agent contacted the organization's President, President, by phone on September 19, 20XX in order to explain, in detail, the proposed revocation and assessment of taxes due on income and as reportable on Form 1120 for the three years under examination. The agent further advised that it may be necessary, on agreement, to prepare a substitute for converted return (SFCR) on behalf of the organization to file for the same three-year period. It was then explained that the agent would require the examined organization's formal position on such revocation and assessment. To this President remarked that agreement is likely based on the knowledge and admission that they (ORG) should have notified the IRS in 19XX-86 of the abandonment of its original exempt purpose, but did not. However, he stated that full agreement cannot be reached without a meeting of the board of directors. To this the examining agent explained that a full proposal would be drafted {cover letter, RAR (Forms 4549 and 886-A) and Form 5701}, submitted to his Group Manager for approval and mailed to the organization to provide an opportunity to examine the position of the IRS.

GOVERNMENT'S POSITION:

The government maintains that four essential violations of tax law have occurred since 19XX.

- First {*violation of section 501(c)(4)*}, there is the failure to reconsider the organization's original exempt purpose when it decided to abandon any fire-fighting activity and instead redirected its purpose to that of a social organization. There is evidence of a long, recent history of an organization, which behaves in the manner of a social organization, but has failed to meet the requirements of a social organization under any of the applicable IRC sections that may have been considered as a potential remedy, and which used the profits to sustain itself without any consideration of taxes on income earned by engaging the general public in a manner similar to, if not exactly like, a for-profit business. The government maintains that such an organization has failed to demonstrate an exempt purpose, routinely failed to recognize its filing requirements and tax obligation, and as such, should have its status, under section 501(c)(4), revoked.
- Second, {violation of section 11 and 6033} the organization failed to report information returns and tax returns.

- Third, {violation of section 61(a)(12)} the organization ignored the fact that, under the rules applicable to taxable and tax-exempt organizations, discharge-of-indebtedness is taxable.
- Fourth, {violation of section 6033(j)} because the organization failed to report for three consecutive years (and more), it should be considered revoked.

RATIONAL/ANALYSIS:

Analysis of Revocation (Proposed By Agent):

First, consider that an organization, which was granted tax-exempt status under section 501(c)(4) of the Internal Revenue Code must show that it operates as a civic league or some such similar organizational structure that is not organized for profit but operated exclusively for the promotion of social welfare. In the present case, this requirement was originally satisfied when the examined organization operated as a fire-fighting company, the obvious social welfare benefit of which was the protection of life and property. When the organization decided in 19XX to retain only the social component of its original fire-fighters, it had an obligation to reconsider its exempt status with the IRS, but did not.

Over a period of many years (19XX to the present) there is an established history of engaging the general public to provide income to support the organization, and this activity very closely resembles the activities of a for-profit social organization, where the profits inure to the members of the organization.

Treasury Regulation section 1.501(c)(4)-1(a)(2)(ii) holds that an organization is not operated primarily for the promotion of social welfare if its primary activity is operating a social club for the benefit, pleasure, or recreation of its members, or is carrying on a business with the general public in a manner similar to organizations which are operated for profit.

Second, consider that the organization completely ignored its filing requirements {see IRC section 6033(j)} for a period of six consecutive years, beginning in 20XX. In an attempt to retain its exempt status the organization filed 990-N (electronic post-card), but failed to file in 20XX, and then filed in 20XX. Not only did the organization violate section 6033(j) from 20XX to 20XX, but it again ignored its filing requirement in 20XX.

Third, there is the continued and observable engagement of the general public in a manner that imitates a for-profit organization, and which activities do nothing to further a charitable or social welfare purpose.

As a final effort to maintain the organization's exempt status, disregarding the failure to file, the for-profit, social activities and the abandonment of fire-fighting, if you consider the small portion of due's used to fund a firemen's relief benefit (fifty cents per member per year with a one-time $500.00 death benefit), you must consider the holding of Revenue Rulings 75-199 and 81-58 (see LAW), which maintain that a membership organization of the type described is essentially a mutual, self-interest type of organization, and therefore, not exempt under section 501(c)(4).

Analysis Of Modification (501(C)(3),(7),(8),(10),(19), (Rejected By Examining Agent):

Ignoring the fact that the organization failed to file tax and information returns for six consecutive years, the agent considered modification of exempt status as provided by other paragraphs under section 501(c). The argument would

be that if an organization can demonstrate compliance with another paragraph of section 501(c), then perhaps a modification would be a remedy.

Consider, for example, modification to the most closely resembled form of organization, a social club, under section 501(c)(7).

In order to meet the strict standards of section 501(c)(7), an organization must show

- its members are bound together by a common objective, and
- the common objective is directed towards pleasure, recreation, and other non-profitable purposes
- the organization must be able to demonstrate compliance with Revenue Procedure 71-17 (Gross Receipts Test), adherence to the host/guest relationship, a restriction against take-out sales, and
- compliance with strict record-keeping requirements imposed by Revenue Procedure 71-17, that clearly indicate the identities of nonmembers

In the present case, the organization operated openly with the general public, with evidence of what was formerly referred to as a "call to action" (proposed regulations), but later modified to read "inducement to purchase, sell, or use any company service, facility or product (see Treasury Regulation 1.513-4(c)(2)(v). This concept of "inducement" is seen in the many online advertisements wherein the organization calls-out to the general pubic (induces) them to enjoy the recreational food, beverages, gaming, dancing or other activities hosted by the organization for a fee. See work papers in section 3-F-3 (Advertising)

It seems clear that even if there was a history of timely filing of 990, this organization would fail to meet the strict requirements of Revenue Procedure 71-17, and in so doing would fail over many years to demonstrate that it behaves in compliance with IRC section 501(c)(7).

In order to stand up to section 501(c)(3), the organization must meet the definition of a charity and be able to pass a public support test, which is not evident in this case. To qualify under sections 501(c)(8) or 501(c)(10) the organization must be part of a lodge system, which it is not. And, lastly, as there is no evidence of a purely veteran-related component, section 501(c)(19) must also be ruled out.

A useful research document that helps explain how the IRS views the process and rejection of modification of status may be found in Private Letter Ruling (PLR) 20XX26040. A PLR is not a citable document. It does, however, serve to illustrate the analytical process taken by the examining agent when excluding other subsections of IRC 501 as a possible remedy for revocation.

(See CONCLUSION, continued on last page of this document)

CONCLUSION:

The examining agent, in consideration of all facts and circumstances, proposes revocation of exempt status, and a tax assessment for the three years ending December 31, 20XX, 20XX and 20XX. The facts and the law {in particular the language of T. Reg. 1.501(c)(4)-1(a)(2)(ii) and the cited rulings} present sufficient arguments to propose revocation, especially in light of the fact that the organization has abandoned its original exempt purpose. This recommendation is offered as a proposal with the intention of securing the organization's agreement and signature on forms 5701, 4549

and 6018-A. Further, it is recommended that the organization consider remittance of the tax due in the amount of $ as indicated at the bottom of page two of Form 4549.

In the absence of forms 1120 for the three years under examination, the agent proposes that he prepare substitute returns (prepared by the IRS, and referred to as converted-returns) on behalf of the examined organization, which will then be the method of reporting income taxes subsequent to December 31, 20XX, and unless or until the organization is able to apply for tax-exempt status under a different paragraph under IRC section 501(c). This approach will create a filing requirement for reporting on form 1120 that will be associated with the organization's current tax ID. That is to say, that subsequent to agreement and payment of taxes, the organization will file income tax returns, Form 1120, unless or until it applies for and is granted tax-exempt status under another provision of IRC section 501(c).

This amount represents adjustments reportable on Form 1120 for the periods ending December 31st, 20XX, 20XX and 20XX, respectively, and does not include interest and/or penalties as may be calculated and assessed by the IRS.