

Internal Revenue Service
Appeals Office
San Jose Appeals, MS-7100
55 S. Market St., Ste. 440
San Jose, CA 95113

Department of the Treasury

Taxpayer Identification Number:

Person to Contact:

Employee ID#:

Release Number: 201415003

Release Date: 4/11/2014

Date: December 19, 2013

Tel:

Fax:

Contact Hours:

Tax Period(s) Ended:

UIL:

0501 .03-22

Certified Mail

Dear :

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (the "Code"). It is determined that you do not qualify as exempt from Federal income tax under section 501(c)(3) of the Code effective January 1, 20xx.

The revocation of your exempt status was made for the following reasons:

- Your primary activity was the regular operation of [] games. The regular operation of games does not, in and of itself, further tax exempt purposes. You have not demonstrated that you operated exclusively for exempt purposes as described in section 501(c)(3) of the Code.
- You operated for the primary purpose of carrying on a trade or business for profit and all of your profits were payable to one or more organizations exempt from taxation under 501. We hereby determined that you are a feeder organization not exempt from taxation as described in section 502(a) of the Code.
- Treas. Reg. 1.501(c)(3)-1(d)(ii) provides that an organization is not operated exclusively for exempt purposes unless it serves a public rather than a private interest. We hereby determined that you operated for the benefit of private interests of a private individual.

Contributions to your organization are not deductible under section 170 of the Code.

If you were a private foundation as of the effective date of revocation, you are considered to be taxable private foundation until you terminate your private foundation status under section 507 of the Code. In addition to your income tax return, you must also continue to file Form 990-PF by the 15th Day of the fifth month after the end of your annual accounting period.

Processing of income tax returns and assessments of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Code.

If you decide to contest this determination, you may file an action for declaratory judgment under the provisions of section 7428 of the Code in one of the following three venues: 1) United States Tax Court, 2) the United States Court of Federal Claims, or 3) the United States District Court for the District of Columbia. A petition or complaint in one of these three courts must be filed within 90 days from the date this determination letter was mailed to you. Please contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217. See also Publication 892.

You also 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 matters that may not have been resolved through normal channels get prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit www.irs.gov/advocate for more information.

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

Sincerely Yours,

Appeals Team Manager

Enclosure: Publication 892



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE
TE/GE EO Examinations
4330 Watt Ave SA6209 EO/MV
Sacramento, CA 95821

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date : **OCT 26 2012**

ORG
ADDRESS

Taxpayer Identification Number:
Form:

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

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear :

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, please sign and return the enclosed Form 6018, Consent to Proposed Action - Section 7428. If you have already given us a signed Form 6018, you need not repeat this process. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals Officer will review your case. The Appeals Office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, The Examination Process, and Publication 892, Exempt Organizations Appeal Procedures for Unagreed Issues, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no

further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Sunita Lough
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination
Form 6018

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG	EIN TIN	Year/Period Ended 20XX12 & 20XX12

LEGEND

ORG - Organization name EIN - ein XX - Date Address - address
City - city State - state Games - games Motto - motto DIR-1,
DIR-2 & DIR-3 = 1ST, 2ND & 3RD DIR RA-1 THROUGH RA-7 - 1ST THROUGH 7TH RA
CO-1 THROUGH CO-11 - 1ST THROUGH 11TH COMPANIES

Issue:

Whether the tax-exempt status of an organization, whose only activity is conducting Motto games while making only insubstantial donations to charity, should be revoked.

Facts:

ORG (ORG) was incorporated in the state of State on December 10, 20XX and recognized as a tax-exempt organization under IRC 501(c)(3) on May 20, 20XX. The organization was presumed to be a publically supported organization described in section 509(a)(1) and 170(b)(1)(A)(vi). On April 10, 20XX the three member board of directors met to restate the charitable activities of the organization as follows:

ORG will provide educational materials to indigent women regarding the risks of breast cancer, the means available for the diagnosis and treatment; it will contract with counselors to provide both pre and post operative counseling for indigent women who are dealing with breast cancer and it's aftermath; it will assist local public school children with health related educational programs; and such other charitable activities as may be approved by the board of directors.

The board of directors held a special meeting on November 2, 20XX, at which time they approved an amendment to their articles of incorporation. Article IIB was amended to state:

The specific purpose of this corporation is to provide money for breast cancer diagnosis and assistance to survivors. To undertake such other charitable projects as deemed necessary.

This change was not reported to the IRS.

From 20XX thru 20XX the board of directors has consisted of three individuals, DIR-1, DIR-2 and DIR-3 all of these individuals were/are employees of CO-1. Per CO-2, RA-1 is the owner/president of this company.

RA-2, a partner in CO-2 and CO-3 (RA-1 is also a partner in these companies) had sole check signing authority. RA-2 was not a member of the board of directors. These two partnerships were major suppliers to the organization. They all shared the Address in City, State

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer ORG	EIN TIN	Year/Period Ended 20XX12 & 20XX12

The board of directors held a special meeting on January 25, 20XX, at which time they resolved that RA-4 and RA-5 may sign on the account at CO-4.

The board of directors held a special meeting on December 1, 20XX at which time they resolved that RA-4 and RA-5 should be removed from the account at CO-4 and that RA-6 and DIR-3 be given signature authority.

The organization conducted weekly Motto events in an effort to raise funds. These Motto games were the organization's only activities. The organization held two sessions per week at the Address, City, State location. They also held sessions at the Address, City, State location throughout the week. The events were open to the general public and ORG estimates that anywhere from 120 to 300 people attended the Motto events. Three types of Motto were generally conducted which are session Motto, electronic Motto, and pull-tabs (called Game games by ORG). Session Motto is basically traditional Motto where a number is called and players mark the number on their corresponding cards, electronic Motto is played with electronic handsets, and pull-tabs are tickets purchased that give a player a chance to win instant cash. No other revenue generating activities were conducted by ORG. The organization does not have a phone number or website. The address listed on their Form 990 was that of the Address office of RA-7 in City.

Total gross receipts for the years 20XX thru 20XX were \$\$ \$\$, and \$\$ respectively. ORG made charitable donations from 20XX thru 20XX. In 20XX the organization donated \$\$ (% of gross receipts) to charity. In 20XX the org donated \$\$ to charity (%) and in 20XX the org donated \$\$ (%)(The total amount claimed by the organization was \$\$ which included \$\$ "donated" to related Motto organizations controlled by RA-1 that have been revoked .These organizations shared resources and expenses).

Year	Gross Receipts	Winner Payouts	Payout %	Donated	Donated Percentage
20XX	\$\$	Unknown	Unknown	\$\$	%
20XX	\$\$	\$\$	%	\$\$	%
20XX	\$\$	\$\$	%	\$\$	%

ORG states that it could not make more charitable distributions because of the high rents and the fact that it is was not profitable and even lost money in 20XX. The majority of the organization's revenue was paid out to winners of Motto games. From looking at ORG's profit and loss statements it can be determined that in 20XX roughly % of gross receipts were paid out to winners of Motto games, % was paid as rental of facilities and Motto equipment, % was paid to

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer ORG	EIN	TIN
		Year/Period Ended 20XX12 & 20XX12

charity. In 20XX roughly % of gross receipts was paid out to winners of Motto games, % was paid as rental of facilities and Motto equipment, less than % was paid to charity. The two largest expenses incurred by the organization are the rental of the building where the Motto sessions are held, and the rental of Motto machines and equipment. For 20XX building rent was \$\$ and for 20XX it was \$\$. In 20XX the rental of Motto machines and equipment was \$\$. In 20XX the total cost of machine rentals was \$\$. ORG leases the Motto hall from CO-5 20XX RA-1 is a partner in this entity. ORG leases Motto equipment from CO-2 20XX . based on a percent of the session's net profits, as well as a flat rate for the rental of handsets. Payments to CO-2 20XX . are typically over \$\$ for each weekend session. It should be noted that RA-4 is the person who signed as the lessor on both the contract between ORG and CO-5 20XX and between ORG and CO-2 20XX This rent is in addition to similar rent charged to another organization using the same facilities on days when ORG does not have Motto sessions. Besides paying rents the organization also paid for utilities and services.

According to an article dated July 1, 20XX in the " " and per the City of City Agenda Report from the Office of the City administrator, Special Activity Unit dated July 10, 20XX:

ORG and another organization at CO-7 rent 24,750 square feet and pay \$\$ per square foot to CO-5, the Motto hall operator, who in turn pays \$\$per square foot to CO-6, the lessor of CO-7 properties.

The organization utilized the services of private security guards at the Motto games, these individuals were treated as private contractors. For the 20XX year they were paid \$\$ and they were paid \$\$ in 20XX. Their services were described as providing protection for the Motto operation. They were paid by check at the end of each Motto session. The organization states that the guards had no direct involvement with the operations of the games. Their duties were described as monitoring doors inside and outside hall, maintaining noise levels and disruptions and player safety.

The organization also paid "volunteer reimbursements" (this amount was included in payouts) in the 20XX year, these amounts ranged from \$\$ - \$\$ per day for a total of \$\$. In 20XX volunteers were paid \$\$ (payments ranged from \$\$ - \$\$ per day) this amount was carried on the books as "electronic reimbursements". It should be noted that on any given day different people were paid different amounts. These individuals served as floor workers and cashiers. Their services were an integral part of the Motto operations which could not have occurred without their labor. That is why these payments are more in line with compensation rather than reimbursements.

On April 30, 20XX the organization was sent a letter from the City City Manager, RA-7, in the letter the City expressed concern about volunteer reimbursements of \$\$ in the March 20XX report that violated the City Municipal Code. On August 14, 20XX RA-1 faxed the City Manager

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG	EIN TIN	Year/Period Ended 20XX12 & 20XX12

a revised report that did not list volunteer reimbursements. It should be noted that RA-1 is not an officer of this organization.

During the years under consideration the organization sold pull tabs during their Motto events.

20XX	
20XX	
20XX	

After being contacted by the IRS and finding out that pull tabs are considered UBI, the org claims that they no longer sell pull-tabs. They now sell games called "Games" these games are a hybrid between a Motto event and pull-tabs.

Law:

Section 501(c)(3) of the Internal Revenue Code exempts from federal income tax organizations organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, educational purposes, to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals, provided that no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the regulations provides that in order to be exempt as an organization described in section 501(c)(3) of the Code, the organization must be one that is both organized and operated exclusively for one or more of the purposes specified in that section.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will not be regarded as operated exclusively for exempt purposes if more than an insubstantial part of its activities is not in furtherance of exempt purposes.

Section 1.501(c)(3)-(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals.

In Rev. Rul. 64-182, 1964-1 C.B. 186, the IRS ruled that an organization qualified for exemption under IRC section 501(c)(3) where it used proceeds from a business activity to conduct a charitable program, commensurate in scope with its financial resources, of making grants to other charitable organizations.

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer ORG	EIN TIN	Year/Period Ended 20XX12 & 20XX12

In *P.L.L. Scholarship Fund vs. Commissioner*, 82 T.C. 196 (1984), a section 501(c)(3) organization conducted Motto games at a commercial lounge. Two of the board members were also owners of the commercial lounge and a 3rd board member was an accountant and director of the commercial lounge. The commercial lounge sold beverages to Motto players. The only expenses paid from the amounts collected for participation in the Motto games are those directly related to the operation of the Motto games, such as prizes, the purchase of supplies, accounting fees, etc. Sales of food and beverages are solicited and made to the Motto players by employees of the commercial lounge. Proceeds from such sales are retained by the commercial lounge separate and distinct from the proceeds of the Motto games. The Tax Court noted that the petitioner engaged in no exempt activities and that the Motto games were conducted in a commercial lounge owned by the organization's director. The court ruled that the scholarship fund was not operated exclusively for exempt purposes.

In *Help the Children, Inc. vs. Commissioner*, 28 T.C. 1128 (1957), a section 501(c)(3) organization conducted Motto games as its principle activity. Its stated purpose was to promote lawful forms of entertainment and amusement to acquire funds and financial assistance for the care and assistance of needy children and children's institutions. Its charitable function consisted of contributions to charitable institutions of amounts that were insubstantial when compared to gross receipts from the Motto games. For the two years under consideration, the percentage of gross Motto receipts that was distributed for charitable purposes was 0.2% and 0.5%. The court held that the organization did not qualify for exemption under IRC section 501(c)(3) because it did not operate any charitable institutions and its principal activity was the profitable operation of Motto games on a business or commercial basis.

In *Better Business Bureau of Washington D.C., Inc. v. United States*, supra, The Court found that the organization had an "underlying commercial motive" that distinguished its educational program from that carried out by a university.

Section 1.501(c)(3)-1(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

An organization must establish that it serves a public rather than a private interest and "that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests." Treas. Reg. §1.501(c)(3)-1(d)(1)(ii). Prohibited private interests include those of unrelated third parties as well as insiders. *Christian Stewardship Assistance, Inc. v. Commissioner*, 70 T.C. 1037 (1978) [CCH Dec. [Link 35,422](#)]; *American Campaign. Academy v. Commissioner*, 92 T.C. 1053 (1989) [CCH Dec. [Link 45,704](#)]. Private

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG	TIN EIN	Year/Period Ended 20XX12 & 20XX12

benefits include an "advantage; profit; fruit; privilege; gain; [or] interest." Retired Teachers Legal Fund v. Commissioner, 78 T.C. 280, 286 (1982) [CCH Dec. [Link 38,818](#)].

An organization must "operate exclusively" for tax-exempt purposes. 26 U.S.C. Sec. 501(c)(3); 26 C.F.R. Sec. 1.501(c)(3)-1(d). An organization's tax-exempt status will not be revoked for providing "incidental" while serving an exempt purpose. American Campaign Academy v. Commissioner, 92 T.C. 1053, 1066 (1989). But a single substantial non-exempt purpose served by the organization does nullify the organization's tax exemption regardless of the quantity or substance of its tax-exempt purposes. *Id.* at 1065; see also 26 C.F.R. Sec. 1.501(c)(3)-1(c)(1) (same). An organization does not operate exclusively for tax-exempt purposes if it serves a private rather than a public interest. Easter House v. United States, 12 Cl. Ct. 476, 487 (1987), *aff'd*, 846 F.2d 78 (Fed. Cir.), *cert. denied*, 488 U.S. 907 (1988); see also 26 C.F.R. Sec. 1.501(c)(3)-1(d)(1)(ii) (same). This requirement applies to the organization's actual, not purported, purposes. American Campaign Academy, 92 T.C. at 1064.

In Christian Stewardship Assistance, Inc. v. Commissioner 70 T.C. 1037 (1978) the court held previously that tax-exempt status is to be denied to organizations that substantially benefit private rather than public interests

State Law – Rent

State Penal Code section 326.5(k)(2) limits the amount for rental of property and overhead to \$\$ per month. The law does not apply to cities that adopt their own ordinances. (State Penal Code section 326.5(a).) City adopted the provisions of the state Penal Code for it's ordinance, thereby adopting the \$\$ per month restriction.

State Penal Code Section 326.5

a) Neither the prohibition on gambling in this chapter nor in Chapter 10 (commencing with Section 330) applies to any Motto game that is conducted in a city, county, or city and county pursuant to an ordinance enacted under Section 19 of Article IV of the State Constitution, if the ordinance allows games to be conducted only in accordance with this section and only by organizations exempted from the payment of the bank and corporation tax by Sections 23701a, 23701b, 23701d, 23701e, 23701f, 23701g, 23701k, 23701w, and 23701l of the Revenue and Taxation Code and by mobilehome park associations, senior citizens organizations, and school districts; and if the receipts of those games are used only for charitable purposes.

(k) With respect to other organizations authorized to conduct Motto games pursuant to this section, all proceeds derived from a Motto game shall be kept in a special fund or account and shall not be commingled with any other fund or account. Proceeds are the receipts of Motto

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG	EIN TIN	Year/Period Ended 20XX12 & 20XX12

games conducted by organizations not within subdivision (j). Those proceeds shall be used only for charitable purposes, except as follows:

(1) The proceeds may be used for prizes.

(2) (A) Except as provided in subparagraph (B), a portion of the proceeds, not to exceed 20 percent of the proceeds before the deduction for prizes, or two thousand dollars (\$\$) per month, whichever is less, may be used for the rental of property and for overhead, including the purchase of Motto equipment, administrative expenses, security equipment, and security personnel.

FINAL-REG, TAX-REGS, §1.513-5. Certain Motto games not unrelated trade or business §1.513-5. Certain Motto games not unrelated trade or business

(a) In general. —Under section 513(f), and subject to the limitations in paragraph (c) of this section, in the case of an organization subject to the tax imposed by section 511, the term “unrelated trade or business” does not include any trade or business that consists of conducting Motto games (as defined in paragraph (d) of this section).

(b) Exception. —The provisions of this section shall not apply with respect to any Motto game otherwise excluded from the term “unrelated trade or business” by reason of section 513(a)(1) and §1.513-1(e)(1) (relating to trades or businesses in which substantially all the work is performed without compensation).

(c) Limitations

(1) Motto games must be legal. —Paragraph (a) of this section shall not apply with respect to any Motto game conducted in violation of State or local law.

(2) No commercial competition. —Paragraph (a) of this section shall not apply with respect to any Motto game conducted in a jurisdiction in which Motto games are ordinarily carried out on a commercial basis. Motto games are “ordinarily carried out on a commercial basis” within a jurisdiction if they are regularly carried on (within the meaning of §1.513-1(c)) by for-profit organizations in any part of that jurisdiction. Normally, the entire State will constitute the appropriate jurisdiction for determining whether Motto games are ordinarily carried out on a commercial basis. However, if State law permits local jurisdictions to determine whether Motto games may be conducted by for-profit organizations, or if State law limits or confines the conduct of Motto games by for-profit organizations to specific local jurisdictions, then the local jurisdiction will constitute the appropriate jurisdiction for determining whether Motto games are ordinarily carried out on a commercial basis.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG	EIN TIN	Year/Period Ended 20XX12 & 20XX12

(3) Examples. —The application of this paragraph is illustrated by the examples that follow. In each example, it is assumed that the Motto games referred to are operated by individuals who are compensated for their services. Accordingly, none of the Motto games would be excluded from the term “unrelated trade or business” under section 513(a)(1).

Example (1). Church Z, a tax-exempt organization, conducts weekly Motto games in State O. State and local laws in State O expressly provide that Motto games may be conducted by tax-exempt organizations. Motto games are not conducted in State O by any for-profit businesses. Since Z's Motto games are not conducted in violation of State or local law and are not the type of activity ordinarily carried out on a commercial basis in State O, Z's Motto games do not constitute unrelated trade or business.

Example (2). Rescue Squad X, a tax-exempt organization, conducts weekly Motto games in State M. State M has a statutory provision that prohibits all forms of gambling including Motto games. However, that law generally is not enforced by State officials against local charitable organizations such as X that conduct Motto games to raise funds. Since Motto games are illegal under State law, X's Motto games constitute unrelated trade or business regardless of the degree to which the State law is enforced.

Compensated Workers – Security Guards

In *South Community Ass'n v. C.I.R.*, U.S. Tax Ct., 20XX. It was found that paid security guards were considered compensated workers, the fact that the security guards who worked in the gaming operation were independent contractors, rather than employees was irrelevant and security guards were part of the workforce of gaming operations.

The role of the security guards as we see it was to prevent a robbery from being attempted in the first place, primarily by virtue of their physical presence at the sites of the Motto games and the instant pull-tab ticket sales. We consider the security guards to be part of the workforce of the gaming operation, cf. *Waco Lodge No. 166, Benevolent & Protective Order of Elks v. Commissioner*, 696 F.2d 372 (5th Cir.1983) (concluding that a bartender's services on Motto night were connected with the carrying on of the Motto games although the bar was down the hall from the games), affg. T.C. Memo.1981-546, and conclude that the security guards worked in the gaming operation for purposes of the “substantially all” test.

In *Julius M. Israel Lodge of B'nai B'rith No. 2113 v. Commissioner*, T.C. Memo 1995-439, aff'd, 98 F.3d 190 5th Cir. (1996) it was held that instant Motto or pull-tabs do not meet the exception of Motto games as stated in Section 513(f) of the Internal Revenue Code. The case held that income from such games did constitute unrelated business income which was subject to tax.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG	TIN EIN	Year/Period Ended 20XX12 & 20XX12

Taxpayer's Position:

The organization has requested a managerial conference. As far as the pull-tabs are concerned, the organization feels that since they are not calling them pull-tabs anymore the sell of these articles should not be considered UBI.

Government's Position:

Based on the facts of the examination ORG does not qualify for tax-exempt status under IRC 501(c)(3) because the organization did not engage primarily in activities that served an exempt purpose. Although the organization's articles state that ORG will provide educational materials to indigent women regarding the risks of breast cancer, the means available for the diagnosis and treatment; it will contract with counselors to provide both pre and post operative counseling for indigent women who are dealing with breast cancer and it's aftermath; it will assist local public school children with health related educational programs; and such other charitable activities as may be approved by the board of directors. This is not the case. The organization primarily exists to hold weekly Motto sessions and virtually no charitable donations are made by the organization. The contributions that are made primarily satisfy the local licensing requirement that contributions be made to local charities. Conducting Motto games while making no significant charitable donations or substantially serving an exempt purpose suggests that more than an insubstantial part of an organization's activities is not in furtherance of exempt purposes. An organization will not be regarded as exempt if more than an insubstantial part of its activities is not in furtherance of exempt purposes. See Treas. Reg. 1.501(c)(3)-1(c)(1).

The organization's sole activity is the operation of the Motto game with the stated intention of turning over any excess funds to charity. All of your support was received as a result of the Motto activity and substantially all of your disbursements were for prizes and operating expenses. Less than % of your total funds were distributed to charity over a three year period. Such minimal disbursements cannot be viewed as commensurate in scope with your financial resources.

In order to be exempt under IRC 501(c)(3), an organization must be organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, educational purposes, etc. An organization that conducts Motto games may be exempt under IRC 501(c)(3) if it uses the proceeds from Motto to conduct a charitable program, commensurate in scope with its financial resources, of making grants to other charitable organizations. See Rev. Rul. 64-182, 1964-1 C.B. 186. In the years 20XX thru 20XX the organization had \$\$ in gross receipts, out of this \$\$ was donated to charity. This represents less than % of total gross receipts. In reference to the organization's charitable giving in 20XX, An article in "CO-8" dated July 1, 20XX, referred to the amount given to CO-9 as an "intra-P.O. Box donation as the organizations have the same address. " The service does not feel that ORG's donations represent a charitable program commensurate in scope with its financial resources as stated in Rev. Rul. 64-182, 1964-1 C.B.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG	TIN EIN	Year/Period Ended 20XX12 & 20XX12

186. In *Help the Children, Inc. vs. Commissioner*, 28 T.C. 1128 (1957), an organization's charitable function consisted of contributions to charitable institutions of amounts that were insubstantial when compared to gross receipts from the Motto games. The court held that the organization did not qualify for exemption under IRC 501(c)(3) because it did not operate any charitable institutions and its principal activity was the profitable operation of Motto games on a business or commercial basis. Case *P.L.L. Scholarship Fund vs. Commissioner*, 82 T.C. 196 (1984) is another example of a Motto organization revoked for no charitable program or activity in place. This case differs slightly from ORG in that it was shown that the Motto operation was primarily setup to bring income in the form of sales of beverages to the owners of the commercial lounge. The basis for revocation was still largely dependent on the fact that no charitable program or exempt activity was supported by the Motto operation.

The organization is operated similar to the organizations described in *Help the Children v. Commissioner*; and *P.L.L. Scholarship Fund v. Commissioner*. These cases involved organizations engaged primarily in fund raising activities through Motto games. The courts held that neither organization qualified for exemption under section 501 (c) (3) of the Internal Revenue code because they were not operated for an exempt purpose.

State Penal Code section 326.5(k)(2) limits the amount for rental of property and overhead to \$\$ per month. The organization paid \$\$ in 20XX which is \$\$ per month which is over 54 times the legal limit. In 20XX the organization paid \$\$ or \$\$ per month which is over 37 times the legal limit. Per IRC 513(f) (2)(c) in able for the Motto activities to not be considered UBI the conduct of those activities cannot violate any State or local law. Reg 1.513-5(C)(3) states that this reg should be enforced regardless if the State enforces the law or not. Thus the conducting of a Motto game which does not fall into the Motto exception is not an exempt activity.

In *Christian Stewardship Assistance, Inc. v. Commissioner* 70 T.C. 1037 (1978) the court held previously that tax-exempt status is to be denied to organizations that substantially benefit private rather than public interests

Paying compensation to individuals, whether or not it is classified as electronic reimbursement or security still is considered disqualifying compensation as found in *South Community Ass'n v. C.I.R.* U.S. Tax Ct., 20XX where the focus was on the work performed in carrying on such trade or business.

Additionally, "no part of the net earnings" of the organization may "inure to the benefit of any private shareholder or individual." 26 U.S.C. Sec. 501(c)(3) (emphasis added); see also 26 C.F.R. Sec. 1.501(c)(3)-1(c)(2) (same). Thus the extent of the inurement is immaterial. *Orange County Agric. Soc'y, Inc. v. Commissioner*, 893 F.2d 529, 534 (2d Cir. 1990); *Freedom Church of Revelation v. United States*, 588 F. Supp. 693, 698 (D.D.C. 1984). "Private shareholder or individual" has been construed broadly by the courts as any person "having a personal or private

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG	TIN EIN	Year/Period Ended 20XX12 & 20XX12

interest in the activities of the organization," including the organization's founder and family. Presbyterian & Reformed Pub. Co. v. Commissioner, 743 F.2d 148, 153 (3d Cir. 1984); see also 26 C.F.R. Sec. 1.501(a)-1(c).

A large percentage of the proceeds after payout went to companies that RA-1 is listed as the owner/president of, or is a partner in. As evidenced by the extremely high rents and high rental fees charged to the organization. These high payments and fees benefit RA-1 more than the insubstantial contributions made by the organization benefit charities. This organization's officers are all in the employ of RA-1. The organization has not demonstrated that it's operation has anything to do with educating or treating women with breast cancer as originally stated in their application when they applied for exemption.

In *Christian Stewardship Assistance, Inc. v. Commissioner* 70 T.C. 1037 (1978) the court held previously that tax-exempt status is to be denied to organizations that substantially benefit private rather than public interests

The organization sold a type of pull-tab that it referred to as "Game". The organization does not consider this device to be a pull-tab that is subject to UBI. The organization purchased these devices from CO-10, State Motto Services and CO-11. In their financial records the organization referred to these items as pull-tabs until they found out that pull-tab sales constituted UBI. They are sometimes referred to as "Event Tickets".

These devices are said to bridge the gap between Motto and pull-tabs. They are described as including the same features of regular pull-tabs but incorporate a second level of play that provides an additional opportunity to win. Event ticket winners are determined by some subsequent action such as a drawing of balls, typically the last ball drawn.

On the State Motto Services website the cards are referred to as a special type of pull-tab that they call Game. The promotion sheets for each game also carry a warning that the manufacturer cannot be responsible for the legality of the game.

The definition of a pull-tab – A pull-tab is similar to a scratch off lottery ticket, but instead it has a number of windows that are peeled open to reveal a possible prize. Each box of pull-tabs contains a set amount of prizes (usually around % of the take). Therefore each box sold is guaranteed a profit.

The "Event" or "Game" type tickets retain all of the attributes listed above as well as it features a number or numbers in the Motto range that when called by the Motto caller entitles the holder to an additional prize.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG	EIN TIN	Year/Period Ended 20XX12 & 20XX12

The income from the sell of pull-tabs when the exceptions to UBI are not met is taxable. The fact that the organization no longer calls them pull-tabs is irrelevant. In the organization's accounting records as well as the reports that were submitted to the city of City they were called pull-tabs.

Conclusion:

The companies controlled by RA-1 directly benefit from the operation of the Motto games. As a result the sole activity of ORG primarily serves the private interest of these companies. Because ORG gives over % of it's after payout proceeds to these companies in the form of various expenses the direct benefit to these companies is substantial. All of the officers of ORG are employees of RA-1. These arrangements causes ORG to be operated for the benefit of private interest in violation of the restriction on private benefit in paragraph (d)(1)(ii) of the section. Based on these facts and circumstances, ORG is not operated exclusively for exempt purposes and therefore is not described in section 501(c) (3).

In a tradition arms length lessee-lessor relationship it is highly unusual for the lessee to give the lessor control of their checking account. Since the organization's inception RA-2, a person with ties to CO-1 and RA-7 has had check signing authority. Then for a period in 20XX, RA-1 was given check signing authority. It should be noted that neither one of these individuals was an officer of the organization.

Because a substantial part of your activities is not in furtherance of an exempt purpose, we have determined that you are not operated exclusively for an exempt purpose pursuant to section 501(c)(3) of the Internal Revenue Code.

The organization has not established that it serves a public rather than a private interest and that it is not organized or operated for the benefit of private interest such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interest. Treas. Reg. 1.501(c)(3)-1(d)(1)(ii). Prohibited private interest include those of unrelated third parties as well as insiders. *Christian Stewardship Assistance, Inc v Commissioner*, 70 T.C. 1037 (1978); *American Campaign Academy v Commissioner*, 92 T.C. 1053 (1989). Private benefits include an advantage; profit; fruit; gain or interest *Retired Teachers Legal Fund v Commissioner*, 78 T.C 280, 286 (1982)

In *Help The Children v. Commissioner of Internal Revenue*, 28 T.C. 1128 (1957), the Court held that an organization engaged in fund-raising activities through operation of Motto games and whose actual charitable contributions consisted of contributions to charitable institutions of insubstantial amounts when compared to the gross receipts from operation of Motto games, did not qualify for exemption under section 501(c)(3) of the Code.

With respect to certain Motto games, section 513(f) of the Code provides that, in general, the

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG	TIN EIN	Year/Period Ended 20XX12 & 20XX12

term unrelated trade or business does not include any trade or business which consists of Motto games (where distributions of prizes are made) so long as the games are not ordinarily carried out on a commercial basis and the conduct of the games does not violate any state or local law.

As the above-quoted sections of the Internal Revenue Code and the applicable regulations indicate, in order for an organization to qualify for recognition of exemption from federal income tax under section 501(c)(3) of the Code, it must be both organized and operated for one or more of the purposes specified in such section.

With respect to those charitable organizations whose purpose is to raise funds from the operation of business with the general public and pay the proceeds to charity, it is the position of the Service that the organization will be entitled to recognition of exemption under section 501(c)(3) of the Code so long as it can be shown to be carrying on a charitable program commensurate in scope with its financial resources. Where the actual payments to charity are an insubstantial amount when compared to its gross receipts, it will not qualify for exemption. This conclusion is warranted regardless of the fact that the conduct of the games conforms with the gaming laws of the jurisdiction.

Based on the amount of gross Motto income that was distributed for charitable purposes, we have concluded that the amount of the proceeds received from Motto activities to conduct charitable programs is not commensurate in scope with the financial resources of your Motto operation.

The organization has consistently paid more than seven fold the amount of rent allowed by State law to entities with ties to the organization. Per Reg. 1.513-5(1) if a Motto game violates state or local law it is considered an unrelated trade or business.

State State Law allows for security personnel to be paid as long as those payments don't exceed \$\$ per month along with rental and other administrative cost. The amounts paid for private security, over \$\$ per year in addition to the monies paid to individuals classified reimbursements exceeding more than \$\$ in 20XX constitute paid compensation which makes the Motto activities not meet the Motto exception to UBI per the code. Because compensation was paid to these individuals the organization does not meet the substantially all test of section 513(a)(1).

Since the organization's activities (Motto is their only activity) do not meet the requirements for Motto games under the code. They constitute substantial non exempt activity.

Based on the foregoing reasons, the organization does not qualify for exemption under section 501(c)(3) and its tax exempt status should be revoked effective January 1, 20XX.

ALTERNATIVE POSITION

Form 886A	Department of the Treasury - Internal Revenue Service		Schedule No. or Exhibit
Explanation of Items			
Name of Taxpayer ORG	EIN	TIN	Year/Period Ended 20XX12 & 20XX12

The income from the sell of pull-tabs when the exceptions to UBI are not met is taxable. The fact that the organization no longer calls them pull-tabs is irrelevant. In the organization's accounting records as well as the reports that were submitted to the city of City they were called pull-tabs. The suppliers still refer to these devices as pull-tabs. Since these devices contain all of the elements that the court found taxable in Julius M. Israel Lodge of B'nai B'rith No. 2113 v. Commissioner, T.C. Memo 1995-439 their sell institutes UBI.