



**DEPARTMENT OF THE TREASURY**

Internal Revenue Service  
TE/GE EO Examinations  
1100 Commerce Street MC 4920 DAL  
Dallas, TX 75242

**TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION**

Date: APR 10 2018

Number: **201829009**  
Release Date: 7/20/2018

Person to Contact:  
Identification Number:  
Telephone Number:  
In Reply Refer to:

**UIL: 501.03-00**

LAST DATE FOR FILING A PETITION  
WITH THE TAX COURT:

**CERTIFIED MAIL – Return Receipt Requested**

Dear :

This is a Final Adverse Determination Letter regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC). Our favorable determination letter to you dated February 13, 20 , is hereby revoked and you are no longer exempt under section 501(a), as an organization described in section 501(c)(3) of the IRC, effective January 1, 20 .

Our adverse determination was made for the following reason(s):

You have not established that you are operated exclusively for an exempt purpose or that you have been engaged primarily in activities that accomplish one or more exempt purposes within the meaning of IRC section 501(c)(3).

You have not established that no part of your net earnings inure to the benefit of any private shareholder or individual.

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

You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the year ending December 31, 20 and for all years thereafter.

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

If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claim Court or the District

Court of the United States for the District of Columbia before the 91<sup>st</sup> day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment.

The Taxpayer Advocate Service (TAS) is an independent organization within the IRS that can help protect your taxpayer rights. We can offer you help if your tax problem is causing a hardship, or you've tried but haven't been able to resolve your problem with the IRS. If you qualify for our assistance, which is always free, we will do everything possible to help you. Visit [taxpayeradvocate.irs.gov](http://taxpayeradvocate.irs.gov) or call 1-877-777-4778.

We will notify the appropriate State Officials of this action, as required by section 6104(c) of the Internal Revenue Code.

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

Sincerely yours,

A handwritten signature in black ink that reads "Maria Hooke". The signature is written in a cursive, slightly slanted style.

Maria Hooke  
Director, Exempt Organizations Examinations

Enclosure:  
Publication 892



Department of the Treasury  
Internal Revenue Service  
Tax Exempt and Government Entities Division

Date:  
September 12, 2017  
Taxpayer Identification Number:

Form:

Tax year(s) ended:

Person to contact / ID number:

Contact numbers:  
Phone Number:  
Fax Number:  
Manager's name / ID number:

Manager's contact number:  
Phone Number:  
Response due date:

**Certified Mail - Return Receipt Requested**

Dear ;

**Why you are receiving this letter**

We propose to revoke your status as an organization described in section 501(c)(3) of the Internal Revenue Code (Code). Enclosed is our report of examination explaining the proposed action.

**What you need to do if you agree**

If you agree with our proposal, please sign the enclosed Form 6018, *Consent to Proposed Action – Section 7428*, and return it to the contact person at the address listed above (unless you have already provided us a signed Form 6018). We'll issue a final revocation letter determining that you aren't an organization described in section 501(c)(3).

After we issue the final revocation letter, we'll announce that your organization is no longer eligible for contributions deductible under section 170 of the Code.

**If we don't hear from you**

If you don't respond to this proposal within 30 calendar days from the date of this letter, we'll issue a final revocation letter. Failing to respond to this proposal will adversely impact your legal standing to seek a declaratory judgment because you failed to exhaust your administrative remedies.

**Effect of revocation status**

If you receive a final revocation letter, you'll be required to file federal income tax returns for the tax year(s) shown above as well as for subsequent tax years.

**What you need to do if you disagree with the proposed revocation**

If you disagree with our proposed revocation, you may request a meeting or telephone conference with the supervisor of the IRS contact identified in the heading of this letter. You also may file a protest with the

IRS Appeals office by submitting a written request to the contact person at the address listed above within 30 calendar days from the date of this letter. The Appeals office is independent of the Exempt Organizations division and resolves most disputes informally.

For your protest to be valid, it must contain certain specific information including a statement of the facts, the applicable law, and arguments in support of your position. For specific information needed for a valid protest, please refer to page one of the enclosed Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*, and page six of the enclosed Publication 3498, *The Examination Process*. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process. Please note that Fast Track Mediation referred to in Publication 3498 generally doesn't apply after we issue this letter.

You also may request that we refer this matter for technical advice as explained in Publication 892. Please contact the individual identified on the first page of this letter if you are considering requesting technical advice. If we issue a determination letter to you based on a technical advice memorandum issued by the Exempt Organizations Rulings and Agreements office, no further IRS administrative appeal will be available to you.

**Contacting the Taxpayer Advocate Office is a taxpayer right**

You have the right to contact the office of the Taxpayer Advocate. Their assistance isn't a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate can't reverse a legally correct tax determination or extend the time you have (fixed by law) to file a petition in a United States court. They can, however, see that a tax matter that hasn't 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:

Internal Revenue Service  
Office of the Taxpayer Advocate

**For additional information**

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,

*Maria Hooke by me*

Maria Hooke  
Director, EO Examinations

Enclosures:  
Report of Examination  
Form 6018  
Publication 892  
Publication 3498

|                      |                                                       |                                        |
|----------------------|-------------------------------------------------------|----------------------------------------|
| Form <b>886A</b>     | Department of the Treasury - Internal Revenue Service | Schedule No. or Exhibit                |
| Explanation of Items |                                                       |                                        |
| Name of Taxpayer:    |                                                       | Year / Period Ended<br>December 31, 20 |

**ISSUE:**

Whether ( ) continues to qualify for exemption under Section 501(c)(3) of the Internal Revenue Code.

**FACTS:**

The organization was organized under Not-for-Profit statutes, and received its certificate of incorporation December 5, 20 .

The organization was granted exemption under 501(c)(3) of the Internal Revenue Code per a Determination Letter dated February 13, 20 . Per the form 1023 'Application for Recognition of Exemption' the organization's Chairman of the Board and Chief Executive Office is

Based on the determination application and its Articles of Incorporation, the organization purposes are:

- a) To promote and advance the arts and music through education
- b) The promotion of cultural events in the local and national community with particular emphasis on jazz music
- c) For the advancement of such music and the education and benefit of jazz musicians and the public
- d) To lessen the burdens of government and for other purposes beneficial to the community, and to devote its net income for such purposes
- e) To make grants to others described in Section 501(c)(3) of the Internal Revenue Code.
- f) To engage in any lawful activity for literary, artistic and scientific purposes within the meaning of 501(c)(3) of the Internal Revenue Code.

More specifically, the corporation expects to:

- a) Sponsor an annual -day jazz festival to promote jazz in order to foster its continued presence in
- b) To provide a weekend of jazz to be enjoyed by its many fans in and other states, and to educate the general public about this uniquely American art form and its development. The event will be called the and will take place at the located in
- c) The purpose of the is to preserve the tradition of the uniquely American art form and to foster enthusiasm for continued live performances.
- d) The corporation also plans to sponsor other similar smaller performances throughout the year.

In the initial interview with the Power-of-Attorney, it was learned the Organization moved the location of the jazz music performances to the restaurant in in 20 , when the sold their property.

On Monday, March 20<sup>th</sup>, 20 , an interview was held at the restaurant with IRS Revenue Agent , IRS Group Manager the two Powers-of-Attorney , CPA, and , CPA, and , Executive VP and Chief Operation Officer of the Organization. During the year under audit, the organization's educational activities consisted of:

- a) Sponsoring live performances of jazz music nights per week at the restaurant in . The performances are through evenings, from roughly 6:30 to 9:30pm. Performances are by & the Jazz Band. This activity comprises approx. hours per week, or hours per month on average). is paid to perform by a related entity owned by the same parent organization.

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- b) Once per month, outside performers are paid to play at the restaurant, usually the first \_\_\_\_\_ of the month. This activity averages \_\_\_\_\_ hours per month.
- c) The Organization pays a local radio station to play recordings of jazz music performed at the restaurant by \_\_\_\_\_ jazz band. This was substantiated by a review of expenses in the General Ledger and testimony by the POA. The broadcast is on \_\_\_\_\_ from 11:00pm to midnight. This activity totals \_\_\_\_\_ hours per month (on average).
- d) Each month, one or two nights per month, the Organization sponsors what they call the \_\_\_\_\_. This program allows aspiring musical artists to gain experience performing in front of live audiences -- the customers of the \_\_\_\_\_ restaurant. Some of the performers are music students at local high schools and colleges who have been referred by their instructors, and some are non-students who have heard of the opportunity to play and contacted the organization on their own. The performers are selected largely on their musical abilities and the portfolio of music they perform. The \_\_\_\_\_ programs are arranged and directed by \_\_\_\_\_, who is a volunteer who donates his time to the org in order to provide jazz music instruction to students and performers around the \_\_\_\_\_ area. He is not an employee of \_\_\_\_\_ or the \_\_\_\_\_; there is no contract or written agreement with \_\_\_\_\_. The musicians are given extensive training and rehearsal sessions from the time they are selected to the date of the performance. I was told the testing component and rehearsal time to be \_\_\_\_\_ to \_\_\_\_\_ hours for each performer. It is unknown how many students perform during a set, but will presume \_\_\_\_\_, so this activity averages \_\_\_\_\_ hours per month (average \_\_\_\_\_ hours per student x \_\_\_\_\_ students x \_\_\_\_\_ nights per month).

From reviewing information on the \_\_\_\_\_ of State website, the Revenue Agent noted the management of the Organization and the restaurant company are materially the same.

The Organization's Board of Directors consists of:

- Chairman, President & CEO (deceased March 4, 20 \_\_\_\_\_).
- Treasurer
- Secretary
- Director
- Director
- Vice President

The management of \_\_\_\_\_, dba \_\_\_\_\_, consists of:

- President (deceased March 4, 20 \_\_\_\_\_).
- Treasurer
- Secretary
- Director
- Director

**LAW:**

Section 501(a) of the Internal Revenue Code provides that an organization described in section 501(c)(3) is exempt from income tax. Section 501(c)(3) of the Code exempts from federal income tax corporations that are organized and operated exclusively for charitable, educational, and other specified purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual.

Treasury Regulation section 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an

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insubstantial part of its activities is not in furtherance of an exempt purpose. Although not defined in the Internal Revenue Code, courts have generally defined 'substantial' to mean 15% or more of total activities. The existence of a substantial nonexempt purpose, regardless of the number or importance of exempt purposes, will cause failure of the operational test. *Better Business Bureau of Washington, D.C., Inc. v. United States*, 326 U.S. 279 (1945).

**§ 1.501(c)(3)-1** In order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

**Operational Test:**

- 1) *Primary activities.* An organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.
- 2) *Distribution of earnings.* 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.

**26 USC § 513 - UNRELATED TRADE OR BUSINESS** The term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501 (c)(3).

**P.L.L. Scholarship Fund v. Commissioner, 82 T.C. 196.** Petitioner was incorporated as a non-profit corporation for the purpose of raising money to be used for providing college scholarships. The money was raised from the operation of bingo games on the premises of a restaurant/lounge. The restaurant is an enterprise for profit, selling food, beverages and liquor. The bingo games are conducted on a regular basis on the premises of the restaurant during the same time that it conducts its regular business activity. The owners of the restaurant/ lounge, conduct the bingo games. Sales of food and beverages are solicited and made to the bingo players by employees of the restaurant. Proceeds from such sales of food and beverages are retained by the restaurant separate and distinct from the proceeds of the bingo games.

The administrative record in this case disclosed that, operationally, petitioner engaged in no exempt activities, that it only operated bingo games, and that such bingo games were regularly scheduled and always held on the premises of a commercial establishment (the restaurant/lounge). The bingo games were conducted by the owners of the lounge who allowed the bingo players to be served food and drink by employees of the restaurant. From the facts presented, it appears more than an insubstantial purpose of the petitioner's activities was to attract persons, by way of the bingo games, onto the premises of the restaurant expecting that they would purchase food and beverage while participating in the games. In fact, it appears that petitioner's activities were, in substantial part, designed to enhance the sales and profitability of the restaurant/lounge.

**Indiana Retail Hardware Association v. U.S., 366 F.2d 998 (Ct. Cls. 1966)** If unrelated business income comprises a "substantial" portion of an exempt organization's income, loss of tax-exempt status may result.

**Arlie Foundation v. IRS 283 F Supp 2d 58 (D.D.C 2003)** the district court found that the operational test requires both an organization engage "primarily" in activities that accomplish its exempt purpose and that not more than an "insubstantial part of its activities" further a non-exempt purpose. Though an incidental non-exempt purpose will not

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automatically disqualify an organization, the "presence of a single nonexempt purpose, if substantial in nature, will destroy the exemption, regardless of the number of importance of truly exempt purposes."

**GOVERNMENT POSITION:**

In accordance with the above-cited provisions of the Code and Regulations under 501(c)(3), Treasury Regulation §1.501(c)(3), and court cases listed above, the Organization is not the type of an organization for which an exemption from tax was intended. The following is a list of issues; anyone of them would disqualify Organization from tax exemption:

1. **Operational Test - § 1.501(c)(3)-1** For an organization to be exempt as an organization described in section 501(c)(3) it has to meet the operational test. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. The Organization has primary activities which it describes as 'educational' (see above under BACKGROUND). Per the Revenue Agent's analysis, these activities comprise an average of \_\_\_\_\_ hours per month, of which \_\_\_\_\_ hours the Service considers to be 'educational'. Thus, over \_\_\_\_\_ % of the Organization's activities are not related to its stated exempt purpose (see 2. below). If more than an insubstantial part of an organization's activities are not in furtherance of its exempt purpose, then it fails the operational test.
2. **Analysis:**
  - (a) Sponsoring live performances of jazz music at the \_\_\_\_\_ restaurant: The Revenue Agent could not discern an educational nexus between a band performing for the entertainment of restaurant patrons, and whatever education the patrons were receiving. Per the court case P.L.L. Scholarship Fund vs. Commissioner cited above, an activity performed in the for-profit venue of the same management group that owns the organization does not have the primary purpose of a tax-exempt activity.
  - (b) An outside jazz band performs for the patrons of the management owned restaurant once per month: Similar to above, the performances are entertainment in nature – no connection was presented for any educational component of the performance.
  - (c) The Organization pays a local radio station to play back recordings of jazz music on \_\_\_\_\_ nights from 11:00pm to midnight that was performed previously at the \_\_\_\_\_ restaurant: The Revenue Agent listened to such radio broadcasts twice on consecutive \_\_\_\_\_ nights. Approximately \_\_\_\_\_ songs were played, and the recordings appeared to be a repeat from the week before. \_\_\_\_\_ voice would narrate each selection by giving the name of the artist or band, the name of the song, and what year it was first performed, and in some instances, some background on the song. No other information was given. \_\_\_\_\_ mentioned the name of the restaurant, or the restaurant/back room, \_\_\_\_\_ times, and mentioned \_\_\_\_\_ and the jazz band \_\_\_\_\_ times. It was mentioned the radio broadcast was sponsored by the \_\_\_\_\_, and the performance \_\_\_\_\_ times at the \_\_\_\_\_ were given several times. It appears to this Revenue Agent that the radio playbacks are more accurately described as an 'info-commercial' than an educational activity.
  - (d) The \_\_\_\_\_: From the description of this activity, the Revenue Agent agrees that this activity is substantially educational.

**Lack of Exempt Activities** – Per the original application for exempt status (see page 1) the Organization stated they would engage in a number of activities. These primarily revolved around promoting and advancing the arts and music through education, and the promotion of cultural events in the local and national community, with particular emphasis on jazz music. Per review of the 990 return, financial statements, Board minutes, and other documents, there is no indication the Organization has promoted any particular local or national events since moving to the greater \_\_\_\_\_ area some years ago, other than the performances at the restaurant noted above.



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**TAX PAYER POSITION:**

The Organization maintains they are an educational entity, entitled to 501(c)(3) status.

**CONCLUSION:**

The organization is not operating within the definition of the Internal Revenue Code for an organization to be tax-exempt under section 501(c)(3). That section of the Code exempts from federal income tax corporations that are organized and operated exclusively for one or more of the purposes listed in that section, and that no part of the earnings inure to the benefit of any private shareholder or individual.

- 1) More than an insubstantial part of the activities of the organization are not in furtherance of an exempt activity, as detailed in the analysis above, and
- 2) Since the same management group controls both the ( ), and the restaurant, and that all activities are held in the restaurant for the benefit of restaurant patrons (with the revenues from sales of food and beverages benefiting the restaurant) then there is substantial inurement to the owners of the restaurant, per court case P.L.L. Scholarship Fund vs Commissioner, as cited above.

The Government concludes that the Exempt Organization, does not meet the requirements to be recognized as exempt from federal income tax under 501(c)(3) of the Internal Revenue Code. Accordingly, the organization's exempt status should be revoked effective January 1, 20 , and that the Organization should have then begun filing a corporate Form 1120 Income Tax Return instead of Form 990, Return of Organization Exempt from Income Tax.