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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

501-04.00

Release Number: **201333018**
Release Date: 8/16/2013
Date: March 4, 2013

LEGEND
ORG - Organization name
XX - Date Address - address

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

ORG
ADDRESS

CERTIFIED MAIL - RETURN RECEIPT REQUESTED

Dear PRESIDENT:

We have completed our examination of your Form 990 for the periods ended December 31, 20XX and 20XX. It has been determined that your exempt status should be revoked.

The previous report of examination issued on November 7, 20XX, states the basis for the revocation. You have concurred with our determination by signing Form 6018, Consent to Proposed Adverse Action, on December 27, 20XX. A copy of which is enclosed. Accordingly, your exemption from Federal income tax under section 501(c)(4) of the Internal Revenue Code has been revoked effective January 1, 20XX.

You are required to file Federal income tax return, Form 1041, with the Internal Revenue Service Center. We have secured the delinquent Forms 1041 for the periods ended December 31, 20XX through December 31, 20XX. When filing future returns, remember the Internal Revenue Code section 277 may limit your deductions.

You also have the right to contact the Office of the Taxpayer Advocate. However, you

should first contact the person whose name and telephone number are shown above since this person can access you tax information and can help you get answers. You can call 1-877-777-4778, and ask for the Taxpayer Advocate assistance or you can contact the Advocate from the site where this issue was determined by writing to:

Taxpayer Advocate assistance cannot be used as substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determination, nor extend the time fixed by law that you have to file a petition in 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.

Please keep a copy of this report with your permanent records.

If you have any questions regarding this matter, please contact the person whose name and telephone number are shown above.

Sincerely yours,

Nanette M. Downing
Director, EO Examination

Enclosure(s):
Publication 892

Internal Revenue Service
Tax Exempt and Government Entities Division
Exempt Organizations: Examinations
Attn: A.C. M/S O540
100 SW Main Street, STE 1200
Portland, OR 97204

Department of the Treasury

Date: February 6, 2013

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

ORG
ADDRESS

Certified Mail – Return Receipt Requested

Dear :

We have enclosed a copy of our report of examination explaining why we believe revocation of your organization's exempt status is necessary.

If you do not agree with our position you may appeal your case. The enclosed Publication 3498, *The Examination Process*, explains 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.

If you request a conference, we will forward your written statement of protest to the Appeals Office and they will contact you. For your convenience, an envelope is enclosed.

If you and Appeals do not agree on some or all of the issues after your Appeals conference, or if you do not request an Appeals conference, you may file suit in United States Tax Court, the United States Court of Federal Claims, or United States District Court, after satisfying procedural and jurisdictional requirements as described in Publication 3498.

You may also request that we refer this matter for technical advice as explained in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*. If a determination letter is issued to you based on technical advice, no further administrative appeal is available to you within the IRS on the issue that was the subject of the technical advice.

If you accept our findings, please sign and return the enclosed Form 6018-A, *Consent to Proposed Action*. We will then send you a final letter revoking your exempt status. If we do not hear from you within 30 days from the date of this letter, we will process your case on the basis of the recommendations shown in the report of examination and this letter will become final. In that event, you will be required to file Federal income tax returns for the tax period(s) shown above. File these returns 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. 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,

Nanette M Downing
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Form 6018-A
Report of Examination

Form **886-A** (Rev. January 1994)	**EXPLANATIONS OF ITEMS**	Schedule number or exhibit
Name of taxpayer ORG	Tax Identification Number EIN	Year/Period ended Dec. 31, 20XX

LEGEND
ORG - Organization name EIN - ein XX - Date Address - address City - city State - state RA-1 & RA-2 - 1st & 2nd RA DIR-1 & DIR-2 - 1st & 2nd DIR
CO-1 THROUGH CO-12 - 1ST THROUGH 12TH COMPANIES

ISSUES:

1) Is the ORG ("ORG") conducting unrelated business activity and, is there any unrelated business income tax due on these activities?

2) Should the exempt status of ORG be revoked as a result of excessive unrelated business activity?

3) If the exempt status should not be revoked, should ORG be required to report the income and expenses related to the non-exempt activity on a Form 990-T?

FACTS:

ORG (ORG) is located at Address, City, State. The entity was originally operated as a for-profit company which began in 19XX. In 19XX, ORG was purchased from the prior owners and operated by DIR-1 until 19XX. In that year, the business operation was turned over to his son, DIR-2. ORG operates under the name of CO-1.

ORG applied for and received exempt status under Internal Revenue Code section 501(c)(4) in November of 19XX. The Form 1024 application for exempt status shows that the exempt purpose of the organization would be to operate a bus line (CO-2) serving the City of City, State.

In 19XX, ORG purchased CO-3 from DIR-2, RA-1 and RA-2 for $$. According to the ORG website, The CO-3 was sold to an outside party in 20XX. In 20XX, the company was re-acquired and renamed as CO-4.

In 19XX, ORG purchased the ORG facility from DIR-1 for $$.

ORG added an airport shuttle service (CO-5) in 19XX, a limousine service (CO-6) in 20XX and a charter bus/tour service (CO-7) in 20XX. In 20XX, ORG purchased two trolleys from DIR-1, RA-1, RA-2 and DIR-2 for $$ which were used in the touring activity.

Financials:

ORG provided the following information in it's General Ledger:

Program Service: Advertising
Program Service: Charter
CO-4
CO-8 Program
CO-9
Title 36 & Similar
CO-10
CO-11
Clearinghouse Processing fees

Form **886-A** (Rev. January 1994)	**EXPLANATIONS OF ITEMS**	Schedule number or exhibit
Name of taxpayer ORG	Tax Identification Number EIN	Year/Period ended Dec. 31, 20XX

LAW:

IRC, 20XX-CODE-VOL, **SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.**

501(c)(4)(A)- Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

501(c)(4)(B)- 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.

FINAL-REG, TAX-REGS, **§1.501(c)(4)-1. Civic organizations and local associations of employees**

(a) *Civic organizations*

(1) *In general.* —A civic league or organization may be exempt as an organization described in section 501(c)(4) if:

(i) It is not organized or operated for profit; and
(ii) It is operated exclusively for the promotion of social welfare.

(2) *Promotion of social welfare*

(i) *In general.* —An organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements. A "social welfare" organization will qualify for exemption as a charitable organization if it falls within the definition of "charitable" set forth in paragraph (d)(2) of §1.501(c)(3)-1 and is not an "action" organization as set forth in paragraph (c)(3) of §1.501(c)(3)-1.

Section 4958(a) (1) of the Internal Revenue Code imposes on each excess benefit transaction, a tax equal to 25 percent of the excess benefit (the "first tier tax"). This tax must be paid by any disqualified person with respect to such transaction.

Section 4958(b) of the Code provides that where an initial tax is imposed, but the excess benefit involved in such transaction is not corrected within the taxable period, a tax equal to 200 percent of the excess benefit involved is imposed and must be paid by any disqualified person with respect to such transaction (the "second tier tax").

Section 4958(c) of the Code, in part, defines "excess benefit transaction" as any transaction in which an economic benefit is provided by an "applicable tax-exempt organization" directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit.

Section 4958(e) of the Code defines "applicable tax-exempt organization" as an organization described in either section 501(c)(3) or section 501(c)(4) of the Code or an organization which was so described at any time during the five-year period ending on the date of the excess benefit transaction.

Section 4958(f)(1) of the Code defines "disqualified person" as (A) any person who was, at any time during the five-year period ending on the date of such transaction, in a position to exercise substantial influence over the affairs of the organization, (B) a member of the family of a disqualified person, and (C) a 35-percent controlled entity.

Treasury Regulations

§53.4958-1(e)(1) of the Treasury Regulations provides that, except as otherwise provided, an excess benefit transaction occurs on the date on which the disqualified person receives the economic benefit for federal income tax purposes.

Treas. Reg. §53.4958-1(c)(2)(i) provides, in part, that if a disqualified person makes a payment of less than the full correction amount under the rules of §53.4958-7, the 200-percent tax is imposed on the unpaid portion of the correction amount (as described in §53.4958-7(c)).

Treas. Reg. §53.4958-1(c)(2)(ii) defines the "taxable period", with respect to any excess benefit transaction, as the period beginning with the date on which the transaction occurs and ending on the earlier of —
(A) The date of mailing a notice of deficiency under §6212 with respect to the §4958(a)(1) tax; or
(B) The date on which the tax imposed by §4958(a)(1) is assessed.

Treas. Reg. §53.4958-1(c)(2)(iii) provides, in part, that the abatement rules of §4961 specifically provide for a 90-day correction period after the date of mailing a notice of deficiency under §6212 with respect to the §4958(b) 200-percent tax. If the excess benefit is corrected during that correction period, the 200-percent tax imposed shall not be assessed, and if assessed the assessment shall be abated, and if collected shall be credited or refunded as an overpayment.

Treas. Reg. §53.4958-7(c) states that the correction amount with respect to an excess benefit transaction equals the sum of the excess benefit (as defined in §53.4958-1(b)) and interest on the excess benefit. The amount of the interest charged for purposes of this section is determined by multiplying the excess benefit by an interest rate, compounded annually, for the period from the date the excess benefit transaction occurred (as defined in §53.4958-1(e)) to the date of correction.

Treas. Reg. §53.4958-4(c)(1) provides that an economic benefit is not treated as consideration for the performance of services unless the organization providing the benefit clearly indicates the intent to treat the benefit as compensation when the benefit is paid. An applicable tax exempt organization is treated as clearly indicating its intent to provide an economic benefit as compensation for services only if the organization provided written substantiation that is contemporaneous with the transfer of the economic benefit at issue. If an organization fails to provide this contemporaneous substantiation, any services provided by the disqualified person will not be treated as provided in consideration for the economic benefit for purposes of determining the reasonableness of the transaction.

Treas. Reg. §53.4958-4(c)(3)(i)(A) provides that an organization's reporting constitutes contemporaneous substantiation to treat a benefit as compensation if the organization reports the benefit as compensation on an original Federal tax information return with respect to the payment (e.g., Form W-2 or 1099); or (B) the

recipient disqualified person reports the benefit as income on the person's original Federal tax return (e.g., Form 1040); or there is an approved written employment contract executed on or before the date of the transfer indicating the benefit is compensation; or there is documentation by the organization's authorized body approving the transfer as compensation for services on or before the date of the transfer; or there was written evidence in existence before the due date of the applicable Federal tax return indicating a reasonable belief by the organization that the benefit was a nontaxable benefit as described in Regulations §53.4958-4(c)(2).

Internal Revenue Code section 512 and 513 - Unrelated Business Income: Unrelated business income is the income from a trade or business that is regularly carried on by an exempt organization and that is not substantially related to the performance by the organization of its exempt purpose or function, except that the organization uses the profits derived from this activity.

Trade or Business: The term "trade or business" generally includes any activity carried on for the production of income from selling goods or performing services. An activity does not lose its identity as a trade or business merely because it is carried on with a larger group of similar activities that may, or may not, be related to the exempt purpose of the organization.

Regularly Carried On: Business activities of an exempt organization are ordinarily considered regularly carried on if they show a frequency and continuity, and are pursued in a manner similar to comparable commercial activities of nonexempt organizations.

Not Substantially Related: A business activity is not substantially related to an organization's exempt purpose if it does not contribute importantly to accomplishing that purpose (other than through the production of funds). Whether an activity contributes importantly depends in each case on the facts involved. In determining whether activities contribute importantly to the accomplishment of an exempt purpose, the size and extent of the activities involved must be considered in relation to the nature and extent of the exempt function that they intend to serve.

In *John Marshall Law School v. United States*, 228 Ct. Cl. 902 (1981) [81-2 USTC ¶9745], The law school and the college paid for the founding family's automobiles, education, travel expenses, insurance policies, basketball and hockey tickets, membership in a private eating establishment, membership in a health spa, interest-free loans, home repairs, personal household furnishings and appliances, and golfing equipment.

The court determined that the expenditures for the founding family were not ordinary and necessary expenses in the course of the law school's and the college's operations. The court also found that the payment of college expenses for the founder's children by the law school provided direct and substantial benefits to the founder of the law school and his brother. The payment of the college expenses helped to defray the costs of their children's education, a cost which they otherwise would have had to satisfy from other resources. The court found these payments to constitute prohibited inurement of the law school's earnings to the founder and his brother, parents of the students

TAXPAYER'S POSITION:

The organization has not yet provided a position and, with this writing, is being given the opportunity to respond.

GOVERNMENT'S POSITION:

ORG does not qualify for exempt status under Internal Revenue Code (IRC) section 501(a) because it is not operating exclusively for an exempt purpose. The organization's primary activity is the conduct of multiple unrelated business activities including a taxi service (CO-4), airport shuttle service (CO-5), limousine service (CO-10), bus charters and tours (Executive Charter Service and Tours).

ORG continues to operate the city bus line (CO-2) that has been in operation since 19XX. The bus line is an exempt activity which alleviates the cost to the local and/or state government of operating a similar mass transit system at public expense. The bus charges riders $ per trip or they can purchase a full day ticket for $. It is apparent that the reduced fee is a benefit to the low income residents of Prescott as well as an incentive which reduces the auto related air pollution in the area.

The CO-4 activity is a typical on-demand taxi service. Taxi's are owned by the drivers and the organization takes a portion of the receipts of the taxi's in exchange for dispatch service and advertising. While there are aspects of this activity that serve a charitable purpose (free rides to veterans to the military hospital, free holiday rides for inebriated persons), it is similar to the operation of most for-profit taxi services. The charitable portion does not change the for-profit nature of the activity.

The limousine service (CO-10) provides chauffeured ultra luxury vehicles which are hired for a set period of time. The chauffeurs provide personal services to the client and the vehicles are stocked with refreshments and equipment designed to pamper the clients while riding to their destination. This is similar to the operation of most for-profit limousine services.

The airport shuttle service (CO-5) provides transportation between fixed points (airport to a pre-designated drop off point and vice-versa) of groups of individuals using vans or small buses. The clients pay a fee that is based on lower costs due as a result of multiple persons traveling to locations within a short distance of each other. This is typical of most for-profit airport shuttle services.

The charter service (CO-7) is designed to transport larger groups of persons from a single pick up spot to a single destination (such as the casinos) or for tours of historical/natural sights (such as the CO-12) and returning the group to the original pick up location. This is typical of most for-profit sightseeing and charter bus services.