Department of the Treasury
Internal Revenue Service
Tax Exempt and Government Entities Division
4330 Watt Ave SA 6209 EO/MV
Sacramento, CA 95821

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Date:
July 26, 2013
Taxpayer identification number:

Form:

Tax year(s) ended:

Person to contact / ID number:

Contact numbers:
Telephone:
Fax:
Manager's name / ID number:

Manager's contact number:

Response due date:

Certified Mail - Return Receipt Requested

Dear :

Why you are receiving this letter
Enclosed is a copy of our report of examination explaining why revocation of your organization's tax-exempt status is necessary.

What you need to do if you agree
If you agree with our findings, please sign the enclosed Form 6018-A, *Consent to Proposed Action*, and return it to the contact at the address listed above. We'll send you a final letter revoking your exempt status.

If we don't hear from you
If we don't hear from you within 30 calendar days from the date of this letter, we'll process your case based on the recommendations shown in the report of examination and this letter will become final.

Effects of revocation
In the event of revocation, you'll be required to file federal income tax returns for the tax year(s) shown above. File these returns with the contact at the address listed above within 30 calendar 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.

What you need to do if you disagree with our findings
If you disagree with our position, you may request a meeting or telephone conference with the supervisor of the 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.

If you and Appeals don't agree on some or all of the issues after your Appeals conference, or if you don't 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.

You may also request that we refer this matter for technical advice as explained in Publication 892. Please contact the person identified in the heading of this letter if you're considering requesting technical advice. If we send a determination letter to you based on a technical advice memorandum issued by the Exempt Organizations Rulings and Agreements office, then 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 Service (TAS). **TAS is your voice at the IRS. This service helps taxpayers whose problems with the IRS are causing financial difficulties; who have tried but haven't been able to resolve their problems with the IRS; and those who believe an IRS system or procedure is not working as it should. If you believe you are eligible for TAS assistance, you can call the toll-free number 1–877–777–4778 or TTY/TDD 1-800-829-4059. For more information, go to www.irs.gov/advocate**. 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 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,

Nannette M. Downing
Director, EO Examinations

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

ISSUES:

1) Whether (Volunteers) section 501(c)(4) exempt status should be revoked effective January 1, 20XX because the organization is not operated exclusively for social welfare purposes.

2) Whether section 501(c)(4) exempt status should be revoked effective January 1, 20XX because it's net income benefited a for profit corporation.

FACTS:

The Volunteers were incorporated in June 19XX in the state of . The Volunteers applied for recognition under IRC 501(c)(4) in January 21, 20XX. They were granted exemption on June 9, 20XX. Their articles of incorporation stated their purpose as: To assist and improve the life of the residents of the . Initially the (Center) was owned by the . The contracted with , a IRC 501 (c)(3) organization to operate the health care facilities. The Center is located in , it provides nursing home and short term care and rehabilitation services. It is an 80 bed facility (the occupancy rate is around 75%). It appears that the ownership of the Center has changed hands a number of times over the years. The latest owner, as of January 1, 20XX is . The , EIN , is a for profit corporation that was incorporated in the state of . Their headquarters are in .

The independent operating subsidiaries provide a broad spectrum of skilled nursing and assisted living services, physical, occupational and speech therapies, and other rehabilitative and healthcare services for both long-term residents and short-stay rehabilitation patients at 63 facilities in , , , , and .

SOURCE

The Volunteers primary activity is the running of a snack bar on the premises of the Center. The Center allows the Volunteers to use the space rent free. The snack bar sells various sundries, candies, sandwiches and other small food items. The snack bar is operated entirely by volunteer laborers, who are usually employees of the Center or officers of the Volunteers. The Volunteer's officers are not compensated. It takes one person to operate the snack bar. Their customer base is the employees, patients and the families of the patients of the Center. The Volunteers did not hold events or have a membership outside of the Center. There wasn't any evidence presented to show that the Volunteers engaged in activities that brought on civic betterments or social improvements to the community at large. The Volunteers also operated a beauty salon on the premises one day per week where the residence of the Center can have their hair styled free of charge. This operation is also staffed by volunteers. On the Volunteer's Form 990EZ under Program

Accomplishments they list donations to the Center for various amounts. The net income of the snack bar is used to purchase items for the Center. For the year ending December 31, 20XX they donated $ to the Center and or stakeholders of the Center. This amounts to approximately 38% of their gross income. From year to year the only asset that the Volunteers carry on their Balance Sheet is cash. All tangible assets purchased during the year such as equipment, tables, lifts, etc are turned over to the Center. Per the Volunteer's Articles of Incorporation upon dissolution all of their assets are to be transferred to the Center. Even capital items purchased to run the snack bar such as a freezer or tables are not on the balance sheet of the Volunteers. The Volunteer's inventory is estimated to be less than $.

On the Volunteer's Form 990 EZ for the year ending December 31, 20XX they list grants and similar amounts paid of $. They list the recipient of these grants as . At the initial interview the Volunteers presented the details for grants given in response to the initial Information Document Request (IDR). Amongst the items listed was an expenditure of $ to for a Hydraulic Lift. In response to the second IDR where substantiation for the expenditure was requested, the Volunteers stated that this was an error and that the expenditure was actually for flat screen television sets for the resident's rooms. They could not produce a receipt for this expenditure, but the provided a signed statement by an officer verifying the transaction. They also listed $ for employee uniforms. It should be noted that the Volunteers don't have employees. The Center has about employees.

LAW:

IRC Section 501(c)(4) of the Code provides for the exemption from federal income taxation of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

Treas. Reg. § 1.501(c)(4)-1(a) states:

(1) 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....

(ii) Nor is an organization operated primarily for the promotion of social welfare if its primary activity is carrying on a business with the general public in a manner similar to organizations which are operated for profit.

(ii) 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 it's primary activity is operating a social club for the benefit, pleasure, or recreation of its members, or is carrying on a business with a general public in a manner similar to organizations which are operated for profit.

In People's Educational Camp Society, Inc. v. Commissioner, 331 F.2d 923 (2nd Cir. 1964), a nonprofit corporation's social welfare activities were supported by its operation of a commercial resort. The court rejected the argument that the resort activities were social welfare and characterized them as business activities. It noted that a large portion of the revenue was being reinvested in the commercial operation. As the business activities were of such magnitude in comparison with the social welfare activities that the organization could not be said to be exclusively (that is, "primarily") engaged in the promotion of social welfare, the court held the organization nonexempt.

Rev. Rul. 66-150, 1966-1 C.B. 147 concluded that an organization which holds title to a building housing its parent, maintains the building, and operates the social facilities located in the building does not qualify for exemption from federal income tax under sections 501(c)(2) or 501(c)(4) of the Code.

Rev. Rul. 70-535, 1970-2 C.B. 117 describes an organization formed to provide management, development and consulting services for low income and moderate income housing projects for a fee. The revenue ruling held that the organization did not qualify under section 501(c)(4) of the Code. The revenue ruling stated : Since the organization's primary activity is carrying on a business by managing low and moderate income housing projects in a manner similar to organizations operated for a profit , the organization is not operated primarily for the promotion of social welfare. The fact that these services are being performed for the tax exempt corporation does not change the business nature of the activity.

In Rev. Rul. 73-349, 1973-2 C.B. 179, an organization was formed to purchase groceries for its membership at the lowest possible prices. It received orders from its members, consolidated them, and purchased the food in quantity. Each member paid for the cost of his food, and each member was assessed an equal monthly service charge for the monthly operating costs. Membership was open to all individuals in a particular community. This revenue ruling stated that the organization was a private cooperative enterprise for the economic benefit or convenience of its members. Citing Commissioner v. Lake Forest, Inc., infra, this ruling stated that the organization operated primarily for the private benefit of members. Any benefits to the community were not sufficient to meet the requirement of the regulations that the organization operate primarily for the common good and general welfare of the people of the community. Accordingly, it did not qualify for exemption under section 501(c)(4) of the Code.

Revenue Ruling 74-99, 1974-1 C.B. 131, held that a homeowners association, to qualify for exemption under section 501(c)(4) of the Code, (1) must serve a "community" which bears a reasonable recognizable relationship to an area ordinarily identified as governmental, (2) it must not conduct activities directed to the exterior maintenance of private residences, and (3) the common areas or facilities it owns and maintains must be for the use and enjoyment of the general public; association of such areas as roadways and parklands, sidewalks and streetlights, access to, or the enjoyment of which is extended to members of the general public, as distinguished from controlled use or access restricted to the members of the homeowners association.

ANALYSIS:

The Volunteers operating a snack bar at a commercial nursing facility does not constitute an exempt purpose standing alone. It was found in Rev Rul 66-150 that the organization did not qualify for exemption under IRC 501 (c)(4) even though they held title to the building, maintained the building and operated the social facilities for the non-profit activities of its parent exempt organization. Originally the Volunteers "supported" an exempt organization; this is no longer the case. Although they facilitated exempt functions, this in itself did not rise to the level necessary to become exempt themselves. In the instant case, the Volunteers merely operate a snack bar for the convenience of a for profit medical facility, thus offering substantially less service than the fore mentioned organization that was denied exemption under IRC 501(c)(4).

Rev. Rul. 70-535, 1970-2 C.B. held that the organization did not qualify under section 501(c)(4) of the Code because the organization's primary activity is carrying on a business in a manner similar to organizations operated for a profit , the organization is not operated primarily for the promotion of social welfare. The fact that these services are were performed for the tax exempt corporation does not change the business nature of the activity. Although there may be some degree of social interaction between the customers and staff at the snack bar, this is not the type of social interaction described in the code. In this case primarily providing services to the Rehabilitation Home residence and employees does not change the character of the business activity.

In Rev. Rul. 74-99 it was held that the organization must serve a community. It defines a community as an entity which bears a recognizable relation to an area ordinarily identified as governmental. Primarily serving the stakeholders of the Center does not meet the requirements of the definition of a community. The stakeholders of the Center consist of the patients, staff members of the Center and visitors (numbers are approximate). Additionally, operating a snack bar and beauty salon primary for the stake holders of a for profit corporation does not promote civic betterment and social improvement for the community.

In People's Education Camp Society v. Commissioner it was held that even though the commercial operation supported the social welfare activities, the commercial activities were held to be the primary activity, thus not qualifying for exemption under IRC 501(c)(4). Other than the operation of the snack bar the Volunteers don't really have any social activity that benefits the community at large.

CONCLUSION:

Social welfare organizations are not precluded from engaging in business activities as a means of financing their social welfare programs. However, the regulations provide that an organization is not operated exclusively for the promotion of social welfare if its primary activity is carrying on a business with the general public. In Rev. Rul. 70-535 an organization that provided various services for low and moderate income housing projects for a fee was not exempt under section 501(c)(4) of the Code because its primary activity was carrying on a business in a manner similar to organizations operated for profit. In the same manner, the Volunteers primary activity is running a snack bar, and not promoting social welfare.

IRC 501(c)(4)-1(a)(ii) states in part that: Nor is an organization operated primarily for the promotion of social welfare if it's primary activity is carrying on a business with the general public in a manner similar to organizations which are operated for a profit. The only difference in the operation of Volunteers operation and that of a commercial snack bar is that Volunteers primarily serve the stake holders of the Center, although walk in customers could be served. It should also be noted the Volunteers do not pay rent or have some of the others expenses that a commercial snack bar would have. The net income of the snack bar is primarily used to purchase items for the Center, albeit some of the items maybe temporarily used by the patients (for example flat screen televisions), the main beneficiary is the Center. These purchases are characterized as grants by the Volunteers. The main benefits are to the Center's patients and employees which does not meet the requirement of the regulations that the Volunteers operate primarily for the common good and general welfare of the people of the community. The patients and employees of the center do not qualify as a community as described by the Revenue Rulings. Accordingly, it does not qualify for exemption under section 501(c)(4) of the Code.

By transferring items to and for the benefit of a for profit corporation, in this case, . The owners of the Center, you serve private interest rather than serving the community at large. An organization that primarily benefits a private group of citizens does not qualify for exemption under IRC 501(c)(4).

Section 501(c)(4) provides that a nonprofit must be operated exclusively for the promotion of social welfare to be exempt. Section 1.501(c)(4)-1(a)(2)(ii) provides 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 of its members. Here, we have found that the Volunteers operated only for the benefit of a select group of individuals and not the general public at large. In addition, the Center is not a community because it is does resemble a governmental subdivision nor does it engage in governmental activities. Therefore, the Volunteer's exempt status should be revoked effective January 1, 20XX.