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No Third Party Contact
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INTERNAL REVENUE SERVICE

NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

District Director
Key District Office (EP/EO)
Information Copy: Chief, EP/EO Division

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification Number:

Years Involved:

Date of Conference:

Legend:

B -
C -
D -
E -
F -
G -

b -
c -
d -

ISSUES:

1. Whether, under the circumstances described, the Post meets the requirements for continued recognition of exemption as an organization described in section 501(c)(19) of the Internal Revenue Code, with deductibility of contributions under sections 170(c)(3) and 2522(a)(4).

2. If the Post remains exempt under section 501(c)(19) of the Code, whether bar/restaurant income from nonmembers, rental income, income from Saturday night dances, and pull-tab revenues constitute unrelated business taxable income under section 512(a)(1).

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FACTS:

The Post is a veterans' organization, which is exempt under section 501(a) of the Code as an organization described in section 501(c)(19) with deductibility of contributions under sections 170(c)(3) and 2522(a)(4). The Post is included in the B group exemption. The Post, which was incorporated on b, was issued a charter by B on c.

The Post follows the B National Constitution. The purposes as stated in the National Constitution are: To uphold and defend the Constitution of the United States of America; to maintain law and order; to foster and perpetuate a one hundred percent Americanism; to preserve the memories and incidents of their association in the Great Wars; to inculcate a sense of individual obligation to the community, state and nation; to combat the autocracy of both the classes and the masses; to make right the master of might; to promote peace and good will on earth; to safeguard and transmit to posterity the principles of justice, freedom and democracy; and, to consecrate and sanctify our comradeship by our devotion to mutual helpfulness.

Eligibility is open to anyone who was a member of the Army, Navy, Marine Corps, Coast Guard, or Air Force of the United States and assigned to active duty at sometime during a period of war, or who, being a citizen of the United States at the time of his entry therein, served on active duty in the Armed Forces of any of the governments associated with the United States. Service from the Armed Forces must have been terminated by honorable discharge or honorable separation. There are only active members. No person may be a member of more than one post at a time, and any person wishing to become a member must show his discharge papers and make an application in writing.

As of September 19, 1993, the Post had 672 members. There were 150 members of D and 110 members of E.

The Post's facility consists of two halls, one for Saturday night dances and the other for rental to individuals or groups, a lounge which contains a bar area, a kitchen, and a meeting room for Post meetings. The building is identified by a sign on the building.

The activities of the Post consist of Saturday night dances and lounge facilities for the members, special occasion parties, bull roasts, Americanism activities, awarding scholarships, and other community activities. The Post donates flags to area schools, donates the meeting room to community organizations and

sponsors baseball teams for various age groups and Scout troops.

The hall is rented to members and the general public. Renters pay a cleaning deposit. If liquor is served, a one day liquor license must be obtained from the county by the renters. Kitchen privileges are not available to the renters who are required to hire a caterer. The Post provides tables and chairs at the option of the renter. The value of the table and chairs is under 10% of the total rents.

The Post's guest policy is posted at the entrance of the lounge and next to the guest book. The Post has implemented a keycard system to limit access to nonmembers and also has a sign-in roster for guests. Guests must leave prior to or at the time the member who signed them in leaves the facility. The guest does not pay for food or beverages at the Post. During the examination the Key District Office ("KDO") noted that the sign-in roster was not accurately maintained.

Pull-tab (instant bingo) tickets are sold at the bar. A separate cash register is used for the sale of the tickets. No box of tickets is opened until the previous box is sold. The tickets are sold by the Post's officers and volunteers. No records were maintained of the gross receipts from the sale of pull-tabs, or amounts of deposits. All amounts relating to pull-tabs were reported net of expenses. No records were maintained detailing the gross sales to qualified members versus other individuals. Pull-tabs were not sold at weekly dances.

Other fundraising activities include dances, appreciation hour, special occasion dances, and parties. For the dances, each member is given 10-15 tickets to sell. No tickets are sold at the door. There are no restrictions on who may attend or to whom members may sell their tickets. The dances are held every Saturday night and are advertised by word-of-mouth. In conducting the weekly dances, the Post is not competing with any commercial enterprise within the area, as there are no commercial "dance halls" in the area.

The Saturday night dances are conducted by volunteer labor. Volunteers do the planning, setting up, and cleaning of the facility. Records were not maintained on the number and hours of volunteer labor used to conduct the dances or the number of persons (members and nonmembers) who attended the dances. It was estimated that setting up for a dance requires five volunteers for two hours each; operating the dance requires eight volunteers for four hours each; cleaning of the facility takes five volunteers an hour and a half; and, 30 members each spend two hours selling tickets and accounting for funds, for a total of

107.5 hours of volunteer labor per dance. Generally, there are two or three paid musicians who play three or four hours for a total of between six and twelve paid hours per dance. Volunteers do not generally receive tips. If tips are received, they go to the Post. For each dance the Post enters into a contract with a band that receives between $250 to $350.

The Post filed Forms 990 for all years under examination, but did not file Forms 990-T. The KDO stated that the Post failed to complete the Forms 990 as required. Such incorrect or missing items relate to the reporting of net revenues from some activities and not segregating the various activities; reporting income from D and E as "contributions," and not attaching all required schedules.

An auxiliary, E, supports the Post and is separately chartered by F. The Auxiliary is tax-exempt under section 501(c)(19) of the Code, as it is included in F's group ruling. The F organization issues membership cards to E's members, who are permitted to use the Post's facilities and participate in the programs and services of the Post. E's members cannot vote at Post meetings, hold positions as a Post officer, or serve on or be appointed to a Post committee.

D is a society within the Post that is also separately chartered. The D society, which abides by the G Constitution and Bylaws, is not recognized as tax-exempt. Membership cards are issued by the G organization. D elects its own officers, uses the Post's facilities and participates in programs and services of the Post. D's members cannot vote at Post meetings, hold positions as a Post officer, or serve on or be appointed to a Post committee. While D is generally considered a youth society, no information was provided as to the age of the members. There are some adult members and some of D's members are also members of the Post. The Post has control of D's funds. Information was not provided as to whether the Post reported the income received or disbursed on behalf of D.

ISSUE 1 - LAW:

Section 501(c)(19) of the Code provides for the exemption from federal income tax of a post or organization of veterans of the United States Armed Forces if such post or organization is:

(a) organized in the United States or any of its possessions,

(b) at least 75 percent of the members of which are past or present members of the Armed Forces of the

United States and substantially all of the other members of which are individuals who are cadets or are spouses, widows, or widowers of past or present members of the Armed Forces of the United States or of cadets, and

(c) no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(19)-1 of the Income Tax Regulations provides that to be described in section 501(c)(19) of the Code an organization must be operated exclusively for one or more of the purposes listed in that section. Section 1.501(c)(19)-1(c)(8) of the regulations lists as one of these purposes the provision of social and recreational activities for the organization's members.

Section 1.501(c)(19)-1(c) of the regulations provides that an organization described in section 501(c)(19) of the Code must be operated exclusively for one or more of the following purposes: (1) To promote the social welfare of the community as defined in section 1.501(c)(4)-1(a)(2) of the regulations, (2) To assist disabled and needy war veterans and members of the United States Armed Forces and their dependents, and the widows and orphans of deceased veterans, (3) To provide entertainment, care, and assistance to hospitalized veterans or members of the Armed Forces of the United States, (4) To carry on programs to perpetuate the memory of deceased veterans and members of the Armed Forces and to comfort their survivors, (5) To conduct programs for religious, charitable, scientific, literary, or educational purposes, (6) To sponsor or participate in activities of a patriotic nature, (7) To provide insurance benefits for their members or dependents of their members or both, or (8) To provide social and recreational activities for their members.

In Senate Report No. 92-1082, 92nd Cong. 2d Sess., Congress stated that for purposes of section 501(c)(19) of the Code, "substantially all" means 90 percent. Therefore, of the 25 percent of the members that do not have to be past or present members of the Armed Forces of the United States, 90 percent have to be cadets, or spouses, etc. Thus, only 2.5 percent of a section 501(c)(19) organization's total membership may consist of individuals not mentioned above.

Section 6001 of the Code provides that every person liable for any tax imposed by the Code, or for the collection thereof, shall keep adequate records as the Secretary of the Treasury or his delegate may from time to time prescribe.

Section 6033(a)(1) of the Code provides, except as provided in section 6033(a)(2), every organization exempt from tax under section 501(a) shall file an annual return, stating specifically the items of gross income, receipts and disbursements, and such other information for the purposes of carrying out the internal revenue laws as the Secretary may by forms or regulations prescribe, and keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Secretary may from time to time prescribe.

Rev. Rul. 59-95, 1959-1 C.B. 627, concerns an exempt organization that was requested to produce a financial statement and a statement of its operations for a certain year. However, its records were so incomplete that the organization was unable to furnish such statements. The Service held that the failure or inability to file the required information return or otherwise to comply with the provisions of section 6033 of the Code and the regulations which implement it, may result in the termination of the exempt status of an organization previously held exempt, on the grounds that the organization has not established that it is observing the conditions required for the continuation of exempt status.

ISSUE 1 - RATIONALE:

An organization described in section 501(c)(19) of the Code carries out activities in furtherance of its exempt purposes only when the activities are exclusively in furtherance of the purposes listed in section 1.501(c)(19)-1(c) of the regulations. Among these purposes is the provision of social and recreational activities for its members. Therefore, when a veterans' organization described in section 501(c)(19) provides social and recreational activities for its members, or for guests whose expenses are paid by members, it is engaged in activities in furtherance of its exempt purposes.

Where goods or services are furnished to nonmembers who provide payment for such goods or services, their furnishing is outside the scope of section 1.501(c)(19)-1(c) of the regulations. Generally, if an organization has not kept adequate books and records concerning its financial transactions with nonmembers and more than 50 percent of its gross receipts are derived from sales transactions (e.g. restaurant and bar sales), the presumption will be that the organization's exempt status should be revoked because it is not primarily engaged in section 501(c)(19) activities. However, this presumption may be rebutted. All facts and circumstances must be reviewed to determine whether or not the organization primarily engaged in section 501(c)(19) activities.

Here, the Post has presented evidence that during the years under examination it engaged in extensive activities that were in furtherance of exempt purposes under section 501(c)(19) of the Code. Such activities include patriotic activities, social activities, membership meetings, and various charitable and social welfare activities.

During the time of the examination there was no permanent mechanism in place to maintain records to distinguish between income from "veteran" members, members' families, bona fide guests, auxiliary members, and non-veterans, in activities such as the bar/restaurant, gambling and social activities. However, it should be noted that the Post has a key card system to limit access to the bar and restaurant. Under these circumstances, members of the general public, if any, using the Post's bar and restaurant facilities may raise an unrelated business income tax ("UBIT") issue (see infra), but would not adversely affect the Post's tax-exempt status under section 501(c)(19) of the Code.

Whether members of the E auxiliary and the D society should be considered members of the Post for purposes of section 501(c)(19) of the Code must be considered to determine if the Post meets the membership requirements of section 501(c)(19). The members of a section 501(c)(19) auxiliary that is related to a post are not considered members of the post, as the auxiliary is a separate organization. Here, the E auxiliary is separately formed and is recognized as tax-exempt and, therefore, E's members are not considered members of the Post.

Even though D is not recognized as tax-exempt, it is an association and chartered by G. D's primary purposes are to promote patriotism and teach leadership to the members. Members of D are not considered members of the Post under the Constitution and By-laws of B. D's members cannot be Post officers or attend Post meetings unless they are also members of the Post. However, D's members may participate in many of the Post's activities, both social and patriotic, as well as have full use of the Post's facilities. As organized, D furthers the Post's exempt purposes under section 501(c)(19) of the Code and may function as a program of the Post. Nevertheless, based on the facts presented in this case, the members of D should not be considered members of the Post. Therefore, the Post would continue to meet the membership limitations under section 501(c)(19).

Although the Post's completing of its Forms 990 for the years in question was not entirely sufficient, we believe the Post has generally maintained the records required under section 6001 of the Code to determine that it meets the requirements for

continued recognition of exemption under section 501(c)(19). Unlike the situation described in Rev. Rul. 59-95, supra, any failings of the Post with respect to recordkeeping and filing returns do not rise to a level that would support revocation of exemption under section 501(c)(19). The KDO may wish to consider whether an inadequate records notice may be appropriate under these circumstances.

ISSUE 1 - CONCLUSION:

Based upon the information presented, the Post meets the requirements for continued recognition of exemption as an organization described in section 501(c)(19) of the Code, with deductibility of contributions under sections 170(c)(3) and 2522(a)(4).

ISSUE 2 - LAW:

Section 511(a) of the Code provides for the taxation of unrelated business taxable income of organizations described in section 501(c).

Section 512(a)(1) of the Code provides, in part, that the term "unrelated business taxable income" means the gross income derived by an organization from any "unrelated trade or business" (as defined in section 513) regularly carried on by it, less certain deductions, and computed with the modifications provided in section 512(b).

Section 512(b)(3) of the Code excludes rents from real property and all rents from personal property leased with such property if the rents attributable to such personal property are an incidental amount of the total rents received. The exclusion does not apply if more than 50% of the lease is attributable to personal property, or if the determination of the amount of such rent depends on the income or profits derived by any person from the property leased.

Section 1.512(b)-1(c)(2) of the regulations excludes rents from real property, and rents from personal property leased with real property, if the rents attributable to personal property generally do not exceed 10 percent of the total rents from all property leased.

Section 1.512(b)-1(c)(5) of the regulations states that payments for the use or occupancy of rooms and other space where services are also rendered to the occupant, such as for the use or occupancy of rooms or other quarters in hotels, boarding

houses, or apartment houses furnishing hotel services, or in tourist camps or tourist homes, motor courts or motels, or for the use or occupancy of space in parking lots, warehouses, or storage garages, do not constitute rent from real property. Generally services are considered rendered to the occupant if they are primarily for his convenience and are other than those usually or customarily rendered in connection with the rental of rooms or other space for occupancy only. The supplying of maid service, for example, constitutes such service; whereas the furnishing of heat and light, the cleaning of public entrances, exits, stairways, and lobbies, the collection of trash, etc. are not considered as services rendered to the occupant.

Section 513(a) of the Code provides that the term "unrelated trade or business" means 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 of its exemption under section 501. The term does not include any trade or business in which substantially all the work in carrying on such trade or business is performed for the organization without compensation.

Section 513(c) of the Code provides that for the purposes of this section, the term "trade or business" includes any activity which is carried on for the production of income from the sale of goods or the performance of services. An activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization. Where an activity carried on for profit constitutes an unrelated trade or business, no part of such trade or business shall be excluded from such classification merely because it does not result in profit.

Section 513(f) of the Code provides that the term "unrelated trade or business" does not include the conduct of certain bingo games. In 1984, Congress passed Pub. Law 98-369, sec. 311(a), subsequently clarified in 1986 by Public. Law. 99-514, sec. 1834, to apply the same treatment to certain "other games of chance" that were then in operation and conducted under a state law enacted on April 22, 1977, subsequently amended to October 5, 1983. This law applies only to gaming activities conducted in the State of North Dakota.

Announcement 89-138, 1989-45 I.R.B. 41, was published by the Service as a reminder to tax-exempt organizations that income

from the public conduct of certain bingo games and other gaming activities may be subject to the unrelated business income tax imposed by section 511(a) of the Code. The Announcement recaps the rules applicable to this area. Currently, income from the conduct of charitable gaming activities, other than bingo, is excluded from the definition of unrelated business taxable income only in the State of North Dakota.

Rev. Rul 69-178, 1969-1 C.B. 158, provides that income from a short term lease that included utilities and janitorial services was rent within the meaning of section 512(b)(3) of the Code and should be excluded in determining unrelated business taxable income.

ISSUE 2 - RATIONALE:

Although the Post is exempt from federal income tax under section 501(c)(19) of the Code, it is still subject to tax on income derived from any unrelated trade or business regularly carried on by it. The Post is subject to the unrelated business income tax on such income if three conditions are present: (1) the income is from a trade or business, (2) the trade or business is regularly carried on, and (3) the trade or business is not substantially related to the exercise or performance by the Post of its exempt function.

The sale of goods or performance of services for the production of income is a trade or business, even when undertaken by a tax-exempt organization. The Post derives profits from activities such as the sale of food and beverages, pull-tabs, and hall rentals, and displays the required profit motive. Such activities, therefore, constitute a trade or business for purposes of section 513 of the Code.

A trade or business is considered to be regularly carried on when the activity is conducted with sufficient frequency and continuity to indicate a continuing purpose of the Post to derive some of its income from such activity. The Post's activities occur on a very frequent basis and, therefore, these activities are regularly carried on.

Clearly, the Post's activities constitute a regularly carried on trade or business. The real issue here, however, is whether these activities are substantially related to the Post's exempt purposes, and whether any of the exceptions contained in sections 512 - 513 of the Code are applicable. Before any activity can be considered substantially related, a nexus must exist between the goods sold or the services provided and the accomplishment of the Post's exempt purposes. If a nexus does

exist, then the revenue generated from such activities will not be treated as unrelated business taxable income.

Section 1.501(c)(19)-1(c)(8) of the regulations lists the provision of social and recreational activities for its members as one of the appropriate exempt purposes of a veterans' organization. This provision permits a post to operate a bar or restaurant for its bona fide members. Any socializing or recreational endeavors sponsored or facilitated by a post should first and foremost focus on the bona fide veteran members. Use of a post's facilities by those other than such veterans needs to be closely scrutinized.

With respect to sales of food and beverages, gambling activities and hall rentals, for purposes of section 501(c)(19) of the Code, revenues derived from bona fide members are not taxable, while amounts from the general public are subject to tax. Falling within the nontaxable category are bona fide guests, i.e., individuals who are accompanied by a bona fide member and who do not themselves pay for food, beverages, or gambling. Also coming within the nontaxable category are certain family members and relatives of the bona fide members, including spouses, children, grandchildren, parents, grandparents, and siblings. These categories of individuals are set forth in section 1.501(c)(19)-1(d)(2) of the regulations, which denotes the membership requirements for auxiliary units of veterans' organizations. Also, members of the Post's auxiliary units or societies would fall within the nontaxable category in computing unrelated business taxable income.

One question presented is whether the use of the Post's facilities by a member of D furthers the exempt purpose of the Post. As organized, D is an appropriate Post function and the use of the Post's facilities in most instances would be consistent with the requirements under section 501(c)(19) of the Code. Based upon the information presented, income from members of D would meet the substantially related test, as their activities are sponsored by the Post and further Post purposes.

Another nontaxable category consists of individuals who, although they are not members of the local Post, are members of other posts that are covered by the C group exemption. In accordance with this category, any bona fide member of a state or National organization, or a local B post could partake of the social and recreational activities offered by the Post. Any revenues resulting from such activities would not constitute unrelated business taxable income because the "substantially related" test under section 513(a) of the Code would be met.

On the other hand, the substantially related test would not be met where food, beverages, and gambling activities are made available to nonmembers of the Post, paying guests, members of the public, and members of veterans' organizations not part of B. Thus, providing goods and services to the foregoing categories of individuals does not contribute importantly to the accomplishment of any exempt purpose listed in section 1.501(c)(19)-1(c) of the regulations.

With regard to amounts derived from hall rentals, the prior analysis is also applicable to the extent that use of the hall by members and individuals in other nontaxable categories would not be subject to tax. With respect to hall rentals that would otherwise be taxable, the question presented is whether such amounts constitute rent from real property that may be excluded from the computation of unrelated business taxable income under section 512(b)(3) of the Code. In connection with some of the rental activities, it appears that no personal services are provided, and no personal property other than chairs and tables (considered less that 10% of the total rental) are provided. The renter must clean the facility, obtain a liquor license, and use a caterer. The renter may also obtain tables and chairs from other sources. In these instances, the Post appears to be similar to the organization described in Rev. Rul. 69-178, supra, which was paid only for the use of space. Determining what portion of total hall rentals, if any, is subject to tax is a question of fact which must be resolved by the Post and the KDO.

The aforementioned distinction between nontaxable members, et al., and taxable members of the public is also applicable to amounts derived from pull-tabs. Thus, amounts attributable to pull-tabs played by members of the Post would not be subject to tax, because such activities are substantially related to the accomplishment of social and recreational purposes set forth in section 1.501(c)(19)-1(c) of the regulations. Based upon the information provided, it also appears that income from pull-tabs that would otherwise be taxable may also be excluded from UBIT, if it is determined that "substantially all" of the work in carrying on the activity is performed without compensation. See section 513(a)(1) of the Code.

The Saturday night dances are regularly carried on for the purpose of raising funds. While the dances may provide social activities for the members, such activities are not limited to members and their bona fide guests, and income from nonmembers would not be considered related income. While no records appear to be maintained regarding the number of hours needed to conduct the dances, the Post estimates that the dances are conducted with substantially all volunteer labor (107.5 volunteer hours and

between six and twelve paid hours per dance). Under these circumstances, income from the dances would not be subject to UBIT as the activity meets the "volunteer labor" exception under section 513(a)(1) of the Code.

ISSUE 2 - CONCLUSION:

A. There is no UBIT on income from members of the Post, members of D and E, bona fide guests, and members of other B Posts.

B. Income attributable to the restaurant/bar, pull-tabs (instant bingo), and Saturday night dances, which is derived from nonmembers, paying guests, members of the public and members of unrelated veterans' organizations, is subject to tax unless the activity meets one of the exceptions contained in sections 511 - 513 of the Code.

C. Income from hall rentals to nonmembers where the rent includes personal property over 10% of total rents or personal services is subject to UBIT.

A copy of this memorandum is to be given to the organization. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

-END-