WORLD SERVICE OFFICE, INC.
NARCOTICS ANONYMOUS
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March 2, 1990

The WSO Board of Directors
Board of Trustees
Administrative Committee

Dear friends,

Enclosed is a draft of part of the report we anticipate for release at the time of the Conference pertaining to resolving the tax matter for the fellowship in the U.S. The report begins with an admonition to keep the information confidential. I bring this to your attention because it is important to remember we are attempting to utilize the Internal Revenue Service code to our benefit. We would prefer not to alert the IRS. This could easily occur if prematurely we allowed copies to be distributed beyond those to whom this is addressed.

This draft has been sent back to the attorney for his further review and it may be revised by him. I fully expect he will revise the conclusions discussed on Page 14.

Also enclosed is the most recent report from him which initiates the second section of our report addressing itself to groups with receipts in excess of $5,000. He and I will meet to discuss this in the near future and I believe some modification of his report will take place. I suspect that the conclusion section of this report will also be modified and may be more specific. Missing from this section of the work is a discussion concerning a parent subsidiary form of compliance. This alternative may be one which is practical to consider, so look forward to changing this in the weeks just before the Conference.

He is still working on a third section which will be a draft of the application for a special ruling should we elect to follow that course of action. He has indicated that it may be available in early April. I am forwarding this information to you to give you the opportunity to read it and begin developing questions. I am hopeful you will write your questions so that when we have the opportunity to meet to discuss these, your questions will be based on having completed research and that you will be reasonably familiar with the content of the reports.

At the last Board of Directors meeting, this issue was discussed. It was the consensus of the Board that we would continue on the course of action earlier advanced by the WSO staff. That earlier plan called for having this report in its entirety duplicated and released at the Conference, along with a cover report which explained a decision-making procedure. The procedure the staff had recommended was to include the motion in the 1991 Conference Agenda Report.

At the February Board of Trustees meeting, there was feeling among the Trustees that this plan was not the most desirable alternative. There was feeling that such a lengthy and complex report would only cause confusion. There was a feeling that World Services should make the decision about how to move forward with appropriate action and not take the matter to the fellowship as WSO had planned. If this approach were followed, I believe it was the intention of the Trustees, that WSO would prepare and file the application for exemption from the regulations without seeking concurrence of the Conference this year and not waiting for the Conference for next year.

Although I am writing this letter just before the Board of Directors meeting and the directors will not see this until they arrive, I wanted to complete the letter so the Trustees would have opportunity to see it before they arrive at their next meeting the following week.

If the Trustees discuss this at their special meeting, it would be helpful to formulate an opinion that can be given to the Board, perhaps as instructions for guidance. I believe it is important that we work together in this matter and the Board of Trustees viewpoint will heavily influence the Board of Directors in this matter. The Conference Administrative Committee should also consider the alternatives for how this information is released and what action steps should be taken with Conference concurrence.

Unfortunately, I will be out of town when you receive this report. I will be leaving over the weekend with Chuck and Stu Tooredman to complete the European work meetings that we talked about at the last meeting.

In service to the fellowship,

Robert B Stone

Bob Stone
Executive Director

BS/dr

Encl. Memo From WSO Dated 4/23/90
Letter From Corliss & Geringer Dated 2/26/90

DATE APRIL 23, 1990

FROM WORLD SERVICE OFFICE
P.O. Box 9999
Van Nuys, California, 91409

DRAFT

TO THE FELLOWSHIP

A REPORT TO THE FELLOWSHIP ON COMPLIANCE WITH FEDERAL TAX REGULATIONS BY NARCOTICS ANONYMOUS IN THE UNITED STATES

For several years, wide discussion has persisted on the subject of tax responsibilities of the Fellowship. In 1989, the World Service Office found then retained the services of an expert tax attorney, familiar with non-profit tax laws and regulations. The attorney was instructed to examine the United States Internal Revenue Service Code and interpret the relevant sections that do or could apply to the various elements of the society of recovering addicts known as Narcotics Anonymous.

This is the report of his work. The report is divided into three sections. Each section pertains to different areas of work he was assigned to research.

1. What is the situation facing groups, meetings and service committees that are small and collect limited amounts of money.
2. What is the situation facing groups, meetings and service committees that are large and collect considerable amounts of money.
3. If the strict application of the regulations would impose administrative hardship on N.A. or divert N.A. from the purpose for which we exist, is there an alternative we can follow?

The World Service Office has also begun to investigate these same issues in other countries and expects to be able help find similar resolutions in the near future.

Since some of the comments set forth in this report are sensitive in nature, it is intended that this report be protected from disclosure to the Internal Revenue Service and other outside parties by the attorney-client and attorney work product privileges. Accordingly, this report has only been provided to you. Neither this report nor its contents should be disclosed to anyone else outside the Fellowship, without first discussing such disclosure with the World Service Office. Disclosure of this letter or its contents to third parties could result in the loss of one or both of the privileges. However, for proper protection we suggest that you not distribute copies of this report.

THE REPORT - SECTION ONE

GROUPS AND COMMITTEES THAT COLLECT LESS THAN $5,000 YEARLY

This report is intended to set forth our understanding of the primary issues and the results of the initial research relating to the tax status and reporting requirements of the various elements of the Fellowship of Narcotics Anonymous ("NA"), and in particular the Groups and service committees at the Area and Regional levels. The primary focus of this first section of the report is the Group level of NA.

The issues presented are complex and do not easily lend themselves to categorization or classification under the Internal Revenue Code of 1986, as amended (the "Code"), the Treasury Regulations, Rulings or case law. We will begin in this report by laying the preliminary foundation for the resolution of the issues presented.

I. Facts.

The relevant facts are as follows: the Groups which compose the core of the NA Fellowship, are in general not incorporated and have not sought or obtained tax exempt status from either the federal government or the states within which they are situated.

The Groups receive most of their support from what are referred to as "contributions." The contributions are made by the members to the Groups on a strictly voluntary basis and in varying amounts. In general, the Groups use the contributions to pay for the meeting locations, refreshments, literature and other miscellaneous expenses relating to group meetings. Most of the Groups are not incorporated, have not filed for or obtained federal or state tax exemptions and do not file any form of income tax or informational return. Additionally, a rather large majority of the Groups have gross receipts of less than $5,000.00 per year.

II. Perspective.

In addition to the evaluation on the current tax situation, this report formulates a resolution of some problems that have been identified. These resolutions take into account the probability that it is not practical to expect the entities at the Group level to comply with rigid or formal reporting or filing requirements.

III. Issues.

The issues of utmost concern relate to the taxability and reporting requirements of the Groups on the receipt of contributions from their members. These issues require an analysis of both the status of the Groups as taxable or nontaxable entities, the reporting requirements of the Groups and the nature and characterization for tax purposes of the contributions.

One of the first questions to have answered is whether or not a Group with gross receipts of less than $5,000.00 per year is exempt from both taxation and the informational reporting requirements.

IV. Summary.

In general, based upon the preliminary research, and assuming that all of the requirements and conditions set forth below have been met, it appears that a Group that has gross receipts of $5,000.00 or less per year may qualify as a tax exempt organization under federal tax law, even though it has not filed a federal application for tax exempt status, and that such group will not have to file an annual information return.

V. Discussion.

The issue of whether groups with de minimums gross receipts are exempt from some or all of the application and reporting requirements, is really two separate questions. First, whether or not such an organization can be exempt from taxes, even though it has not applied for or obtained an exempt status, and secondly, whether or not if exempt, it must nevertheless file annual information returns.

For purposes of this discussion, it is assumed that the tax exempt status of WSO does not shelter or provide tax exempt status to the Groups. In making this assumption, leaves open for another time a detailed analysis of whether or not either (i) an argument may be structured to include the Groups under the WSO tax exempt status as it presently exists, or (ii) whether or not WSO may seek a group exempt status that would pull the Groups under the WSO tax exempt status. This was not made a primary focus of the research, because the preliminary investigation indicates there will be problems with either approach based upon the lack of supervision or control exerted by WSO over the Groups. In terms of the historical and spiritual background of N.A. it would not appear to be desirable to consider such an idea.

In general, an organization seeking tax exempt status under Section 501(c) (3) of the Code, must notify the Secretary of the Treasury that it is seeking such status in order to be recognized as tax exempt under federal law. [Code Section 508 (a).] There is, however, what is referred to in this report as a "de minimums exception" to this notice requirement. If an organization is not a private foundation and the gross receipts of the organization in each taxable year are normally not more than $5,000.00, then such organization may be automatically exempt, without the need to file form 1023 putting the Secretary of the Treasury on notice. [Section 508(c) (1) (B).] Such an organization must, however, otherwise meet the requirements for Section 501(c) (3) of the Code.

This presents a potentially very beneficial situation with respect to the NA structure. Based upon the understanding that a majority of the Groups have gross receipts of $5,000.00 or less each year. If it can be established that the Groups are not private foundations, which analysis focuses on the contributions, and otherwise meet the requirements of Section 501(c) (3) of the Code, then it appears that the Groups may be automatically exempt from taxes without the need the file an application for tax exempt status. If that is a correct conclusion, then a substantial amount of the NA structure will be eliminated from the exempt notice requirements, which will allow focus to be centered on the units not covered by the de minimis exception.

Generally there is a notice requirement placed upon an organization in order for it to be classified as a non-private foundation. Our preliminary research indicates that an organization exempt from the notice requirements relating to filing a Form 1023 are exempted from this private foundation notice requirement.

However, there is a certain degree of risk in making a unilateral determination that a Group is not subject to the notice or reporting requirements of the Internal Revenue Code. The Internal Revenue Service can always challenge that unilateral conclusion and make a determination to the contrary. If the organization wants to be assured of its exempt status, it must go through the normal application procedure with the Internal Revenue Service and receive a ruling or determination letter recognizing its exempt status. That course of action does not appear practical under the facts as we understand them.

The second general rule that we must deal with is that tax exempt organizations typically must file an annual information return (Form 990). [Code Section 6033(a) (1).] Once again there is a "de minimums exception." An organization that is not a private foundation, and that has gross receipts of $5,000.00 or less each year is not required to file an information return. [Code Section 6033(a) (2) (A) (ii); Treas. Reg Section 1.6033-2(g) (1) (iii).] We therefore believe that if the other requirements set forth above with respect to the notice requirements are met, that such Groups will not be required to file information returns.

The Requirements of De Minimis Exception and Non-Private Foundation Status

1. Overview.

The general goal is to exclude the receipts of the NA Groups from federal income tax, and from any income reporting, or any notice or application requirements imposed by the Internal Revenue Code of 1986, as amended (the "Code"). Tax exempt status would of course provide for much of the desired treatment. However, tax exempt status normally has to be sought through a notice and application procedure. The Code provides what we have referred to as a "De Minimis Exception" for organizations that meet certain requirements. In general, the De Minimis Exception imposes three requirements, to wit:

A. Gross receipts of $5,000.00 or less per year;

B. Operation otherwise in compliance with Section 501(c) (3) of the Code;

C. Non-private foundation status under Section 509 of the Code.

If the organization satisfies these three requirements, then it may qualify as a tax exempt organization under the Code, and not be required to (i) file an Application for Tax Exempt Status ("Application"), (ii) file information returns, or (iii) file a notice that it intends to be treated as a non-private foundation.

2. Non-Private Foundation Status.

In order to qualify under the De Minimis Exception, the NA Group must not be a private foundation. In general, private foundation status relates to the sources of support of the organization. If the support is from a broad enough cross-section of the general public, then the organization will be considered to be a publicly supported charity which is not a private foundation. On the other hand, if the organization receives support from too narrow a cross-section of the public, then it will be classified as a private foundation under Section 509 of the Code.

The classification of an organization as a private foundation has several deleterious effects, many of which are not important for this discussion. The primary effect of private foundation classification with which we are concerned is the loss of the availability of the De Minimis Exception.

A. General Presumption.

There is a general presumption under the Code that a Section 501(c) (3) organization is a private foundation [Code Section 509(a)]. It is the responsibility of any organization desiring to be treated as a non-private foundation (hereinafter "public charity") to establish that it is not a private foundation. In order to be classified as a public charity, the organization must fit within one of the exceptions set forth in Section 509 of the Code. There are a number of exceptions set forth in the Code, however, we believe that the so called publicly supported organization exception, is the most applicable exception for purposes of the characterization of the NA Groups under discussion [Section 509(a) (2)].

B. Publicly Supported Organization Exception.

In general, the publicly supported organization exception provides that an organization normally receiving more than 1/3 of its annual support from members and the general public ("Required Support") and not more than 1/3 of its annual support from investment income (**Investment income means the gross amount of income from interest, dividents, payments with respect to securities, loans, rents, and royalities, but not including any such income to the extend included in computing the tax imposed by section 511 on unrelated business income. [See Section 509(e)] [Section 509(d)]**) or unrelated business income ("Prohibited Support"), will be considered to be a private foundation. It can be seen that the publicly supported organization exception has two separate sub-parts or tests, both of which must be satisfied in order for an organization to qualify under this exception. On the one hand, the Required Support element dictates that the organization must receive a certain amount of support from good sources. that is, from the general public. On the other hand, the Prohibited Support element dictates that the organization must not receive too much of its support from bad sources, that is, investment income or income not related to the charitable business of the organization (collectively sometimes referred to herein as "Unrelated Income") (**An exempt organization is subject to tax on its unrelated trade or business income if two conditions are met: (i) The income must be from a trade or business regularly carried on by the organization; and (ii) the trade or business must not be substantially related to the organization's exercise or performance of the purposes or functions on which its exemption is based [Code Section 511]**). The first part focuses on desired sources of support. The second part focuses on undesired sources of support. These fractional tests look like this:

$$\text{REQUIRED SUPPORT} = \frac{\text{Public Support}}{\text{Total Support}} \text{ -- } 1/3$$

$$\text{PROHIBITED SUPPORT} = \frac{\text{Unrelated Income}}{\text{Total Support}} \text{ -- } 1/3$$

Both tests involve comparing the Required Support or the Prohibited Support, as the case may be, to the total support received by the organization from all sources. In the first case, Required Support must be equal to or greater than 1/3 of all support received by the organization. In the second case, the Prohibited Support must not exceed 1/3 of all support received.

Amounts received from disqualified persons (**A disqualified person is (i) a substantial contributor to the organization, (ii) a foundation manager, or (iii) the owner of more than 20% or more of the voting power of a corporation, the profits interest of a partnership, or the beneficial interest of another entity that is a substantial contributor to the foundation. There are other categories discussed in the Code, however, they are not important for purposes of this discussion. A substantial contributor is any person who contributed more than %5,000 to the private foundation, if such amount is more than two percent of the total contributions and bequests received by the foundation before the close of the taxable year of the foundation in which the contribution or bequest is received [Section 507(d) (2)]**), from governmental units, or from organizations described as Section 170(b) (1) (A) organizations (**The term 170(b) (1) (A) organization in general refers to a church, a designated educational or medical institution, or a qualified publicly or governmentally supported organization**), are not included in the numerators of either test. Disqualified persons, governmental units Section 170(b) (1) (A) organizations shall be hereinafter sometimes collectively referred to as "Disqualified Entities."

Support (hereinafter, "Total Support") is the general, all inclusive category. encompassing all revenue received by the organization except gain from the sale or exchange of a capital asset. It is the denominator in each fractional test discussed above, and includes (i) gifts, grants, contributions, or membership fees, (ii) gross receipts from admissions, sales of merchandise, performance of services, or the furnishing of facilities in any activity (which is not an unrelated trade or business), (iii) net income from unrelated business activities, (iv) gross investment income, and etc. [Section 509(d)].

A distinction must be drawn between two of the subcategories of Total Support, "grants" and "gross receipts." The term "grants" includes grants, gifts, and membership fees. Grants are included in full in Total Support (the numerator of the fraction), unless the amount is received from a Disqualified Entity, in which case they are entirely excluded.

Gross receipts, on the other hand, have additional limitations which must be met before they are included in Total Support. They are included in Total Support (the numerator) only to the extent they are (i) not received from an unrelated trade or business (as defined in section 513 of the Code) and (ii) are generated from admissions, sales of merchandise, performance of services, or furnishing or facilities. In calculating this gross receipts' amount, receipts in excess of $5,000 or one percent of the organization's support in such taxable year, received from any person or any bureau or similar agency of a governmental unit, are excluded (such excluded receipts shall be sometimes hereinafter collectively referred to as "Disqualified Contributions"). While contributions from Disqualified Entities are entirely disregarded, Disqualified Contributions are only disregarded if they are in excess of the $5,000 or one percent limitation.

Thus, in determining whether the Required Support test is satisfied, an organization must start with a calculation of Total Support, then subtract any contributions from Disqualified Entities, any Unrelated Income (gross receipts from admissions, sales of merchandise or performance or services or the furnishing of facilities in an unrelated trade or business), and any Disqualified Contributions. The result of this calculation will provide the numerator of the fraction for the Required Support test. If Require Support is equal to or greater than one third of Total Support, then the first part of the public support test will have been met.

A similar procedure is used with respect to Prohibited Support, which is calculated by totaling up all investment income, and all income not related to the charitable purpose of the organization. If Prohibited Support is less than or equal to one third of Total Support, then the second element of the public support test is met.

It is the presumption of this work that the support for NA Groups with gross receipts of $5,000 or less comes substantially, if not entirely, from the contributions of its members, who are all individuals. Such contributions would appear to be related to the exercise by the organization of its charitable purpose. Assuming no member contributes the $5,000 maximum under discussion, then there would be no contributions from Disqualified Entities, no Unrelated Income and no Disqualified Contributions. Such groups would meet the Required Support test and the Prohibited Support test. Accordingly, we believe that the NA Groups would satisfy the requirements of the publicly supported organization exception of Section 509 of the Code, and would accordingly be most likely accorded public charity status.

3. Publicly Supported Organization Exception; 509(a) (1).

There is another publicly supported organization exception, this one set forth in Section 509(a) (1). The Groups may have a problem qualifying for this exception, but since the percentage tests are more easily met, we will proceed to briefly discuss this exception. Under this exception, there are a number of alternative tests, any one of which can be used to qualify for the exception. Of the various alternative tests, there is only one that warrants further discussion, sometimes referred to as the Section 170(b) (1) (A) (vi) organization exception (hereinafter, the "(a) (1) Exception").

Under the (a) (1) Exception, there are two alternative tests, either of which must be satisfied. The first is the 33 1/3 percent support test; the second is the 10 percent support test. This test is quite similar to the Required Support test discussed in Paragraph a. above. One third (1/3) of the support of the organization must come from the general public. There is no Prohibited Support test that applies. However, under this test, any amount received from the exercise or performance by the Group of its charitable purpose or function, is not included in support. Under the applicable law, it is not clear whether the contributions made by members to the Groups, are contributions received from the exercise or performance by the Group of its charitable purpose. If they are, then the Groups would not be able to satisfy either the 33 1/3 percent support test or the 10 percent support test under the (a) (1) Exception.

The second test, referred to as the 10 percent support test, requires that 10 percent of the support of the organization come from the general public in order for the organization to qualify as publicly supported. There are other requirements imposed, two of which are worth mentioning. The organization must be organized and operated to attract new and additional public or governmental support on a continuous basis, and the organization must establish by other facts and circumstances that is entitled to be recognized as a publicly supported organization [Treas. Reg. 1.170A-9(e) (3) (ii) and (iii)]. Once again, the organization cannot count receipts from the exercise or performance by the Group of its charitable purpose or function. We have discussed the (a) (1) Exception because it is one of the major exceptions used by 501(c) (3) organizations to qualify as public charities and it may be applicable at other levels of the Fellowship structure. However, the open question with respect to the character of the contributions received by the Groups, that is, whether or not received in performance of the organizations charitable purpose, did not appear to warrant further research at this time.

Our overall conclusion with respect to the public charity status of the Groups currently under consideration, is that the factual context within which the Groups operate supports the position that they meet the publicly supported organization test and that they have a very good argument that they are not private foundations, which is crucial with respect to the De Minimis Exception.

4. Section 501(c) (3) Requirements.

A. General Rule.

We next turn to the second, final and perhaps most important element to be considered with respect to the De Minimis Exception, to wit: satisfaction of the Section 501(c) (3) requirements.

In order for an organization to qualify for tax exemption under Section 501(c) (3), it must be:

i. A corporation, community chest, fund or foundation;

ii. Organized and operated exclusively for...charitable...purposes;

iii. No part of the net earnings of which inures to the benefit of any private shareholder or individual;

iv. No substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation...(**Section 501(c) (3) of the Code**).

B. Form of Entity.

In order to be a Section 501(c) (3) organization or for that matter any tax exempt organization, the organization must be operated in one of the legal forms recognized by the Code. These forms include: corporation, trust, partnership, or unincorporated association (**To qualify in this regard, an unincorporated association or a partnership must be taxable as a corporation under Code 7701(a) (3) and Treas Reg. 310.7701-2**). The Groups are not incorporated, and are not formal trusts or partnerships. In fact it is our understanding that most of the Groups have very little formal organization at all. This may well present one of the most substantial problems to attaining tax exempt status. This aspect will be discussed further in the next section.

C. Organized and Operated Exclusively for Charitable Purposes.

In order to be exempt for tax purposes, an organization must be organized and operated exclusively for one or more of the purposes set forth in the Code [Treas. Reg. 1.501(c) (3)-1]. We believe that the purposes for the Groups would qualify as charitable in nature.

Generally, however, the organization is considered to be organized for charitable purposes, only if its articles, or organizational documents, limit such organization to exempt purposes, and do not empower the organization to engage in other non-exempt purposes [Treas. Reg. 1.501(c) (3)-1(b)]. The definition of articles includes the corporate charter, the articles of association, or any other written instrument by which an organization is created (**Treasury Regulation 1.501(c) (3) -2**).

Since the Groups do not have articles of incorporation, not corporate charters, we must focus on any other written instruments by which the organization is created. One possible writing which might be argued to govern the operation of the Groups are the Twelve Traditions of the Fellowship. The courts have interpreted the term "organized" to mean "created to perform" or "established to promote." This is a rather broad interpretation which may very well be broad enough to encompass a writing such as the Twelve Traditions. We believe that there are some additional actions that could be taken to strengthen this position, and we will address them later.

D. No Private Inurement.

The next requirement is that of private inurement. In general, the assets of the organization must not accrue to the private benefit of any one. The term private inurement is not directly defined in the Code or the Treasury Regulations, although Congress has indicated that it is concerned with the improper disposition of the exempt organization's "net earnings."

An organization is not prohibited from using the net earnings to pay ordinary and necessary expenses of the organization, which may include compensation for services or the purchase of property, provided that it is reasonable or in an arms-length transaction. What is prohibited is unreasonable compensation or excessive purchase prices. We do not believe that the groups should have much difficulty here, from the standpoint of salaries or the purchase of products at excessive prices, since it is our understanding that there are not salaries paid at the group level, and that very little is purchased.

The two facts that may cause a problem in this regard are the use of private bank accounts by the Treasurer's of some of the Groups, and the problem that has been experienced with some of the Groups, when one of their members improperly takes some of the funds. The prohibition against private inurement is one of the requirements of Section 501(c) (3) of the Code. Due to this prohibition, no one may obtain private benefit from an exempt organization, that is, no one is allowed to personally gain from the assets and income of the exempt organization.

It is clear that members of the Groups do not receive any income, and the revenues collected from member contributions are used to defray the cost of Group meetings or buy World Service Office - N.A. literature, which is in turn given or sold (usually below cost) to the members of the Groups. Based upon these facts, we do not believe that there is a private inurement problem.

E. No Propaganda or Attempt to Influence Legislation.

The final requirement for attaining 501(c) (3) classification is that no substantial part of the activities of the organization is carrying on propaganda or the attempt to influence legislation. We are not aware of any facts with respect to the Groups that would indicate any lobbying or propaganda activities. In fact, there is a direct prohibition of such activities in the Twelve Traditions. We accordingly do not believe that this point should pose a problem.

5. Organizational Requirement.

Tax exempt treatment under Section 501(c) (3) of the Code is only available if the organization is "organized" for charitable purposes. In general, only "corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, ..." purposes, qualify for tax exempt treatment ("form of entity requirement") (**Code 501 (c) (3); Treas. Reg. 501(c) (3)-2.**). Accordingly, not everyone can qualify for tax exempt status under Section 501(c) (3); for example, an individual or a partnership would not qualify for Section 501(c) (3) treatment. The Groups do not appear to clearly fit within any of the categories set forth above, and it is this requirement that we believe presents the greatest obstacle for tax exempt treatment encountered by the Groups.

To being with, an unincorporated association is included within the definition of "corporation" as long as it is taxable as a corporation (**Code 7701(c) (3); Treas. Reg. 301.7701-2**). We believe that classification as an unincorporated association provides the best opportunity to the Groups for meeting this form of entity requirement.

There are six characteristics that are evaluated to determine whether an association should be classified, and therefore taxed, as a corporation: (i) associates; (ii) an objective to carry on business and divide the gains therefrom; (iii) continuity of life; (iv) centralization of management; (v) liability for corporate debts limited to corporate property; and (vi) free transferability of interests (**Treas. Reg. 301.7701-2**). In general, an unincorporated association must have more corporate characteristics than noncorporate characteristics to be classified as a corporation (**Treas. Reg. 301.7701-2 (a) (3)**). If one of the characteristics is common to both the corporate and noncorporate forms being evaluated, it is not considered (**Id.**).

We believe that there is a strong argument that the Groups have associates, continuity of life, and centralized management, three corporate characteristics. We do not believe that the Groups have limited liability or free transferability of interests, two noncorporate characteristics. We believe that there is support for the position that the requirement that there be an objective to carry on a business and divide the gains therefrom, characteristic number (ii) above, should be dropped out of the consideration because it does not apply to a nonprofit venture. If it is dropped out of consideration, then there would be three corporate characteristics and two noncorporate characteristics, which we believe would result in the Groups being characterized as associations taxable as corporations.

We have not as yet been able to find any authority that clearly deals with this issue. We have, however, located one case that is helpful to our position (**Morey v. Riddell (1962 S.D.Cal) 205 F. Supp. 918**). The case involved a church that had no identifying name, no written charter, constitution, bylaws, or operational guide other than the Holy Bible. It had no permanent headquarters, did not maintain comprehensive records, and did not hold its funds in a bank account designated as the church account (**Id., at 919**). The government contended that the contributions to the church did not qualify as a charitable deduction, because the church was not "organized" as required by the applicable federal tax statutes (**The court in Morey v. Riddell analyzed the language under Section 23 of the Internal Revenue Code of 1939 and Section 170 of the Internal Revenue Code of 1954. Those sections contain language substantially similar to Section 501(c) (3) of the Code**).

The Court found that the church adhered to a common philosophy, bound themselves together in an organized association, held regular public meetings for Bible study, worship and evangelism, sponsored radio broadcasts and printed and distributed Bible literature. "They recognized specific individuals as ministers and as church officers, from whom they accepted guidance (**Id., at 920**)." The Court concluded that "while the church lacks some of the common indicia of organization, it plainly is an organized association of persons dedicated to religious purposes (**Id.**)." As such the contributions were deductible and the church was determined to be "organized" in compliance with the applicable federal tax laws.

The Morey v. Riddell decision (the "Decision") determined that the church was sufficiently "organized" to satisfy the requirements under federal tax laws. The organized requirement, which is also found in Section 501(c) (3), is generally satisfied by including certain language in the documents by which the organization is formed and governed. The court in Morey determined that a group could be sufficiently "organized" under the right circumstances, even without a governing instrument or charter. While this may provide some comfort for the current situation with respect to the Groups, it should not in our opinion be relied on for planning purposes. Rather, we suggest that effort be made to strengthen the position of the Groups with respect to the "organized" requirement. As we have discussed, the Treasurer's Handbook might well become a document that the Groups could look to as a charter or governing instrument. In this regard, it should contain a statement of the exempt purposes, which may already be set forth in the Twelve Traditions, and should also contain a statement dedicating the assets of the Groups to a charitable purpose in the event a group is dissolved (**Id.**).

By taking the actions set forth above, we believe that Groups could strengthen their position with respect to the necessary organization under Section 501(c) (3) of the Code to qualify for the De Minimis Exceptions and thereby tax exempt status.

6. Conclusion. (Don, in this section we need to make substantial change by including as much of a declarative statement of what the small groups are to do and how they are to do it. I have added language at the end to suggest what I mean.)

We have now discussed the major issues relating to Groups with annual gross receipts of $5,000 or less per year and the elements of the De Minimis Exceptions under the Code. This analysis was made to evaluate the current situation and the potential problems with respect to these Groups. While we believe that the Groups would have reasonably strong arguments that they satisfy the requirements necessary to qualify for the De Minimis Exceptions and that they are therefore exempt organizations under Section 501(c) (3) of the Code, such an evaluation is subjective and not determinative of the issue. Only an Internal Revenue Service (the "Service) or court determination is dispositive and can assure tax exempt status. Accordingly, the Service could always disagree with this conclusion and challenge the Groups assertion that they are tax exempt.

Based on the above information, the following course of action can be recommended: Small groups that will collect less than $5,000 in receipts from all sources and want to abide by the de minimus option as a practice can do so easily.

A. They should obtain and complete accurately each year, a Group Treasurers Workbook. This record of financial activity should be kept and available for review by the IRS for a period of at least seven years.

B. The group should fill an SS-4 form and receive their own Tax Identification number. The number should be used only by the group that obtains it. If the group is divided and a new group(s) formed, the new group(s) should obtain their own Tax Identification form and keep their own records.

C. All funds received by the group should be deposited into the bank account and all disbursments made by check. If checks are made to individuals who purchased items for cash that the group used, the individual must not be given the check until receipts equal to the amount of the check are presented.

D. If the group closes, the bank account must be closed and the funds given to another group or committee that has a tax identification number and is maintaining proper records. The prior Group Treasurer Workbooks should be kept in a secure place that is accessable if the IRS ever wants to review the information.

E. If during the year, the group determines that it will have receipts for the full year in excess of $5,000, the group may elect to take one of the following options.

(1) Divide the group and start a second and independent group with its own officers and tax identification number.

(2) Follow the course of action discussed in the next section of the report on groups that receive more than $5,000 in a year.

(3) If the receipt of $5,000 in a single year is an unusual situation and the group receives less than $5,000 in the years before and after, the group may be eligible to retain its status without additional action. The group should, however, seek clarification and assistance in the matter from the Region.

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CORLISS & GERINGER

A LAW CORPORATION

February 26, 1990

File No. 103.01

HAND DELIVERED

Mr. Robert Stone
Executive Director
World Service Office, Inc.
P.O. Box 9999
16155 Wyandotte
Van Nuys, California 91409

Re: Groups with Annual Gross Receipts in Excess of $5,000

Dear Bob:

Enclosed is the long awaited installment dealing with Groups, Area Service Committees and Regional Service Committees with annual gross receipts in excess of $5,000. Because of the time deadlines, the next two installments will come in rapid succession. I anticipate one more installment by the end of this week, and another one at the beginning of the next week.

The next installment will be directed at the requirements for a group exemption. The following installment will be directed at the ruling request procedure. I also would like to start preparing the full report for the World Service Conference, which will serve as an aggregation of all the prior letters to you on this subject. I will tie everything together in that report and will make suggestions of alternative courses of action that may be taken.

I know that you have been working on tying all the prior reports together. So as not to overlap our efforts, I would appreciate it if you could provide me with a copy of your draft to date. I know you are extremely busy and would be glad to finish the draft if you have not had time to do so. Please let me know.

Very truly yours,

CORLISS & GERINGER
A Law Corporation

Donald M. Corliss Jr.

DONALD M. CORLISS, JR.

DMC/jt
Enclosures

CORLISS & GERINGER

A LAW CORPORATION

February 26, 1990

File No. 103.01

ATTORNEY CLIENT AND WORK PRODUCT PRIVILEGED COMMUNICATION

Mr. Robert B. Stone
Executive Director
World Service Office, Inc.
Narcotics Anonymous
P.O. Box 9999
16155 Wyandotte
Van Nuys, California 91409

Re: General Discussion of Groups with Gross Receipts in Excess of $5,000 per Year

Dear Bob:

With this installment, we turn our focus to Groups, Area Service Committees, and Regional Service Committees with gross receipts **in excess** of $5,000 per year (collectively, **"Large Groups"**). As you will recall, the focus of our discussion for Groups with annual gross receipts of **less** than $5,000 (hereinafter, **"Small Groups"**) was the **"De Minimis Exception,"** which exempted such Groups (i) from filing an application for tax exempt status, (ii) from filing a notice that the group intended to be treated as a non-private foundation, and (iii) from filing annual information returns (sometimes collectively referred to herein, as the **"Filing and Notice Requirements"**).

The De Minimis Exception is limited to organizations with gross receipts of $5,000 or less per year. By definition then, the Large Groups do not qualify for the De Minimis Exception. Since there is no other exception applicable to the Large Groups, they must, in order to qualify as tax exempt, comply with not only the requirements of Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the **"Code"**), but all of the Filing and Notice Requirements.

In our previous letters relating to Small Groups, we have discussed in quite some detail the requirements that such Groups must satisfy in order to qualify for tax exemption, including the conditions set forth under Section 501(c)(3) of the Code (hereinafter, **"Section 501(c)(3)"**). That discussion, in so far as it relates to the Section 501(c)(3) requirements and non-private foundation status, is equally applicable to Large Groups. In the remainder of this letter, we will briefly review the requirements that must be met in order to obtain tax exempt status for Large Groups.

1. **Federal Tax Exempt Status.**

a. **The Notice Requirement.**

While there is more than one possible Code section under which the Groups might assert tax exempt status, we will limit our discussion in this letter to Section 501(c)(3), which is the section of the Code under which World Service Office, Inc. ("**WSO**") has obtained its tax exempt status. As we have stated in earlier letters to you, in general, an organization seeking tax exempt status under Section 501(c)(3) must meet the requirements set forth in that Section, and must notify the Secretary of the Treasury (the "**Secretary**") in writing that it is seeking such status.[1] This notice requirement is met through the filing of an application for ruling, Form 1023, Exemption Application, with the district director of the Internal Revenue Service (the "**Service**").

Satisfying the requirements of Section 501(c)(3) is not in and of itself sufficient to qualify an organization to be tax exempt. The organization must file its application for ruling and have its exemption given official recognition by the Service before it will be recognized as exempt under Section 501(c)(3).[2] In addition to notifying the Secretary that it is claiming tax exempt status, such an organization must otherwise meet the requirements of Section 501(c)(3) of the Code.

Under the facts as we understand them, the Large Groups do not appear to be tax exempt under the Code, unless and until they seek and obtain a ruling determination of such status from the Service.[3] We will continue our discussion with respect to the Large Groups to determine whether they have the necessary characteristics, as they are now constituted, to obtain exempt status if they were to apply for it.

b. **Section 501(c)(3) Requirements.**

i. **General Rule.**

In order for an organization to qualify for tax exemption under Section 501(c)(3), it must be: (1) A corporation,

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[1]Code §508(a).

[2]Code §508(a).

[3]We will address the issue of a group exemption later in this letter and in the next installment.

community chest, fund or foundation; (2) organized and operated exclusively for charitable purposes; (3) have no part of its net earnings inure to the benefit of any private shareholder or individual; and (iv) not have any substantial part of its activities involve the carrying on of propaganda, or otherwise attempting, to influence legislation.[4] Each of these Section 501(c)(3) requirements must be separately met, both at the time that an organization seeks tax exempt status and throughout its operations.

ii. Form of Entity.

Tax exempt treatment is only available to certain forms of tax exempt organizations. In general, such treatment is available only for corporations, community chests, funds, or foundations.[5] These generic forms of organization can be divided into three different categories, to-wit: unincorporated associations, trusts and corporations. In fact, an unincorporated association is technically included within the meaning of "corporation," as long as it is taxable as a corporation.[6]

There are six characteristics that are evaluated to determine whether an association should be classified, and therefore taxed, as a corporation,[7] and Large Groups must have more corporate characteristics than non-corporate characteristics in order to receive the tax exempt treatment sought. As previously set out with respect to Small Groups, we believe there is support for the position that Large Groups have more corporate characteristics than non-corporate characteristics.

iii. Organized and Operated.

Large Groups must be organized and operated exclusively for charitable purposes.[8] Generally, an organization will be considered so organized only if its articles or organizational documents limit the activities of such organization to its exempt charitable purposes, and do not empower it to engage in other non-exempt purposes.[9] Additionally, to some extent, recognition as an acceptable form of entity depends upon having a

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[4]Code §501(c)(3).

[5]Code §501(c)(3); Treas. Reg. §501(c)(3)-2.

[6]Code §7701(c)(3); Treas. Reg. §301.7701-2.

[7]Treas. Reg. §301.7701-2.

[8]Treas. Reg. §1.501(c)(3)-1.

[9]Treas. Reg. §1.501(c)(3)-1(b).

sufficient structure and organization. The organization's charter or articles are frequently looked to, to supply such organization.

Where there are no articles or charter, an organization may look to any other written instrument by which it is created,[10] and the term **"organized"** has been interpreted to mean **"created to perform"** or **"established to promote."** The Large Groups do not technically have a charter or articles, and the lack of such identifiable documents could, and quite probably would, create some difficulties in dealing with the Service.

We believe that the best argument available to the Large Groups in this regard is that the Twelve Traditions constitute a sufficient organizational document to meet this test and that the Large Groups are established to promote the Twelve Traditions. As we set out in our October 20, 1989 letter to you, there is some favorable case law authority which we believe would support the position that the Small Groups, and also the Large Groups, are sufficiently **"organized,"** as required by the federal statutes, to meet the organizational test.[11] However, we believe that the Large Groups position could be significantly strengthened by taking the actions outlined in our October 20, 1989 letter to you with respect to the Small Groups.

iv. <u>No Private Inurement.</u>

The assets of an organization must not inure to the private benefit of anyone. While not specifically defined in the Code, the term private inurement has been indicated to be directed at the improper distribution of **"net earnings."** An organization is not prohibited from using net earnings to pay ordinary and necessary expenses of the organization, which may include compensation for services or the purchase of property, provided that it is reasonable or in an arms-length transaction. Based upon the facts with which we are aware, we do not believe this requirement presents any significant problems.

v. <u>No Substantial Propaganda Activities.</u>

No substantial part of the activities of the organization may be directed at the carrying on of propaganda or the attempt to influence legislation. This does not appear to be a problem for the Large Groups.

c. <u>Probability of Qualifying for Tax Exempt Status.</u>

Subject to the limitations set forth in this letter,

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[10]Treas. Reg. §1.501(c)(3)-2.

[11]<u>Marey v. Riddell</u> (1962 S.D.Cal) 205 F.Supp 918.

we believe that there is a strong likelihood that the Large Groups would be able to qualify for tax exempt status should they apply for it.

2. <u>Non-private Foundation Status.</u>

There is a general presumption under the Code that a Section 501(c)(3) organization is a private foundation.[12] In order to avoid this statutory presumption of private foundation status, an organization must give notice to the Service that it intends to be treated as a public charity.[13] Such notice is generally given with the filing of the Form 1023, Exemption Application. It is the responsibility of any organization desiring to be treated as a public charity to establish that it is not a private foundation, and in order to be classified as a public charity, the organization must fit within one of the exceptions set forth in Section 509 of the Code.

Public charity status is essential for purposes of qualifying for the De Minimis Exception, since it is one of the preconditions of that exception. However, since the De Minimis Exception is not available to the Large Groups under discussion in this letter, public charity status is not essential to their tax exempt status, and they could be tax exempt as a private foundation. While there are advantages to being classified as a public charity, such as the absence of the excise taxes that apply to private foundations and larger limits on deductibility of contributions by contributors, we will not engage in a discussion of the benefits in this letter.[14] What is important to note is that for the Large Groups to be public charities they must file a written notice of such intention with the Secretary. The failure to file such a notice results in private foundation status.

Based upon the information we have reviewed, we believe that the Large Groups would otherwise most likely be able to qualify as public charities, were they to comply with the Filing and Notice Requirements.

3. <u>Annual Information Return Requirements.</u>

If the Large Groups are not tax exempt, then they are required to file annual federal and state income tax returns. Even if the Large Groups are tax exempt, there is a requirement that

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[12]Code §509(a).

[13]Code §508(b).

[14]If an analysis of the consequences of private foundation status is desired, we will provide it to you in a subsequent letter.

they file Form 990, annual information returns, with the Service.[15] No exceptions will exempt the Large Groups from such filing requirements.

4. **Conclusion.**

The focus of this letter has been the probable status for federal income tax purposes of Large Groups, if such Groups are viewed as independent units. In general, we have concluded that Large Groups, when viewed as independent units, do not qualify for the De Minimis Exception and that they are most likely taxable entities. Under the general principles set forth herein, Large Groups are required to affirmatively seek tax exempt status by the filing of an application for ruling determination, Form 1023, Exemption Application, with the Service. Absent such notice and recognition of tax exempt status by the Service, it is most likely that the Large Groups will be considered taxable entities, subject to filing federal income tax returns and paying taxes on any net taxable income.

Even if the Large Groups were to be recognized as tax exempt without filing a Form 1023, they would be presumed to be private foundations, subject to certain additional excise tax provisions and requirements under the Code, and would be required to file annual federal returns, either income tax or informational.

We will withhold our final recommendations to you with respect further possible action until the conclusion of the next installment. We have to this point focused our attention on the probable status of the Small Groups and Large Groups if allowed to stand on their own as separate entities. We will turn our attention in the next installment to an analysis of group exemptions and consider the possibilities of seeking a blanket group exemption that would apply to all levels of the Fellowship.

Very truly yours,

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[15] Code Section 6033(a)(1).