INTERNAL REVENUE SERVICE
District Director

Department of the Treasury

UZL
501.07-05

Person to Contact:

Telephone Number:

Refer Reply to:

Date: APR 0 7 1999

Dear Sir or Madam:

We have completed our examination of your Form 990EZ for the periods ended (nd It has been determined that your exempt status should be revoked.

The enclosed report of examination states the basis for the revocation. You have concurred with our determination and have signed an agreement to that effect. Accordingly, your exemption from Federal income tax under section 501(c)(7) of the Internal Revenue Code has been revoked effective

As a taxable entity, you will be required to file the appropriate federal income tax return for subsequent years.

Thank you for your cooperation.

Sincerely yours,

District Director

Enclosures

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer		Year Ended

FACTS:

The club was created in . to:
1) further the advancement of all breeds of purebred dogs; and
2) conduct training classes, sanctioned & licensed obedience trials

In a letter dated ,ne club was granted exempt status under section 501(c)(7) of the Internal Revenue Code.

Based upon the information submitted, the Club does not maintain any records to substantiate the amount of gross receipts received from non-members. In my letters dated and , I requested copies of any records or documents the Club has verifying the amount received from non-members. In your response, you stated that you do not have any such records. You stated "We do not keep track of that information."

Based upon the information submitted, we have determined that the Club received more than 42% of their total gross receipts from non-members This is based upon the following facts:
1) During the years examined, the Club had approximately 220 members, paying annual dues of $120. Income received from membership dues constitutes only 42% of the Club's total income.
2) The Club received more than 55% of their total income from trials, sales of equipment, raffles, socials, etc. No records were kept to establish how much *(if any)* of this income was received from members.
3) A comparison of the Club's membership roster to 17 deposit slips disclosed that more than 72% of the money deposited came from non-members.

In addition, the club received $838.57 and $889.44 in investment income.

LAW:

Section 501(c)(7) of the Internal Revenue Code provides exemption to "Clubs organized for pleasure, recreation, and other nonprofitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder."

Section*1.501(c)(7)-1(b) of the Income Tax Regulations relating to the exemption of social clubs, reads, in part, as follows:

"(b) A club which engages in business such as making its social and recreational facilities available to the general public ... is not organized an operated for pleasure, recreation, and other nonprofitable purposes, and is not exempt under section 501(a). Solicitation by advertisement or otherwise for public patronage of its*facilities is prima facie evidence that the club in engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes..."

LAW: (cont'd)

Revenue Procedure 71-17,*published in Cumulative Bulletin 1971-1 page 683 sets forth guidelines for determining the effect of gross receipts derived from nonmember use of a social club's facilities on the club's exemption under section 501(c)(7), and states, in part, as follows:

> "Where a club makes its facilities available to the general public to a substantial degree, the club is not operated exclusively for pleasure, recreation, or other nonprofitable purposes. See Rev. Rul. 60-324, C.B. 1960-2,173; and Rev. Rul. 69-219, C.B. 1969-1, 153."

Section 3.01 of Revenue Procedure 71-17, describes the minimum gross receipts standard, and states, in part, as follows:

> "A significant factor reflecting the existence of a nonexempt purpose is the amount of gross receipts derived from use of a club's facilities by the general public. As an audit standard, this factor alone will not be relied upon by the Service if annual gross receipts from the general public for such use is $2,500 or less or, if more than $2,500, where gross receipts from the general public for such use is five percent or less of total gross receipts of the organization..."

Prior to the enactment of Public Law 94-568, an organization was required to be organized and operated exclusively for pleasure, recreation and other nonprofitable purposes.

The Committee Reports show that the wording change was intended to make it clear that social clubs may receive up to 35 percent of their gross receipts, including investment income, from sources outside their membership without losing their exempt status. Within this 35 percent limitation, no more than 15 percent of gross receipts may be derived from non-member use of the club's facilities and/or services.

In addition, the statute prohibits exemption under section 501(c)(7) if any part of the organization's net earnings inures to the benefit of any private shareholder.

Traditionally, inurement has been found to be present where a club derives income from non-member sources and uses it to reduce the cost of providing services to members. Revenue Ruling 58-589, 1958-2 C.B. 266, states, in part, as follows:

> " Net earnings may inure to members in such forms as an increase in services offered by the club without a corresponding increase in dues or other fees paid for club support or as an increase in the club's assets which would be distributable to members upon the dissolution of the club."

Revenue Ruling 79-145, published in Cumulative Bulletin 1979-1 on page 360, states that "amounts paid to a social club by visiting members of another social club are amounts paid by nonmembers, even though both clubs are of like nature and the amounts paid are for goods, facilities, or services provided by such social club under a <reciprocal> arrangement with such other social club."

Revenue Ruling 71-421, published in Cumulative Bulletin 1971-2 on page 229, holds that a dog club "formed to promote the ownership and training of purebred dogs and conducting obedience training classes, may not be reclassified as an educational organization exempt under section 501(c)(3)."

LAW: (cont'd)

Revenue Ruling 73-520, published in Cumulative Bulletin 1973-2 on page 180, provides that a club that promotes and protects a particular breed of dog not raised or used by members as farm animals is not exempt as an agricultural organization under section 501(c)(5) of the Code.

CONCLUSIONS:

Based upon the information submitted, your club receives a substantial part of your income from the use of your facilities and services by the general public.

Therefore, we have determined that your exempt status under section 501(c)(7) of the Internal Revenue Code should be revoked.