

**DEPARTMENT OF THE TREASURY**

INTERNAL REVENUE SERVICE

TE/GE: EO Examinations

625 Fulton Street, Room 503

Brooklyn, NY 11201

501.07-00

**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

December 17, 2012

Number: **201318026**

Release Date: 5/3/2013

Legend

ORG = Organization name XX = Date

**ORG
ADDRESS****Taxpayer Identification Number:
Form:****Tax Year(s) Ended:
December 31, 20XX
Person to Contact/ID Number:
Contact Numbers:**

Dear :

This is a final determination regarding your exempt status under section 501(c)(7) of the Internal Revenue Code (IRC). Recognition of your exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(7) is retroactively revoked to January 1, 20XX because it is determined that you have not established that you are observing the conditions required for the continuation of an exempt status.

We previously provided you a report explaining the proposed revocation of your tax-exempt status. At that time, we informed you of your appeal rights. By signing Form 6018, *Consent to Proposed Action*, you indicated that you accept our determination to revoke your organization's exempt status.

We have determined that you fail to qualify for exempt status under any other subsection of IRC 501(c).

You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for all years beginning January 1, 20XX. We have secured Form 1120 tax returns for the years ended December 31, 20XX and December 31, 20XX.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal

appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter.

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez
Director, EO Examinations



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service
Tax Exempt and Government Entities
230 S. Dearborn, MS:4923-CHI
Chicago, IL 60604

June 11, 2011

ORG
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear :

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

If you do not agree with our position you may appeal your case. The enclosed Publication 3498, *The Examination Process*, explains how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

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

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

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

If you accept our findings, please sign and return the enclosed Form 6018, *Consent to Proposed Adverse Action*. We will then send you a final letter modifying or revoking exempt status. If we do not hear from you within 30 days from the date of this letter, we will process your case on the basis of the recommendations shown in the report of examination and this letter will become final. In that event, you will be required to file Federal income tax returns for the tax period(s) shown above. File these returns with the Ogden Service Center within 60 days from the date of this letter, unless a request for an extension of time is granted. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Form 6018
Report of Examination
Envelope

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Period Ended
ORG		20XX12

Legend

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Issues:

1. Revocation of an organization granted exemption under IRC Section 501(c)(7).

Facts:

ORG was recognized as exempt under IRC Section 501(c)7, in June of 19XX. The purpose of the organization per their organizing documents is to promote an interest in clay target shooting of all kinds, to provide fellowship through mutual interest, to provide instruction in the safe handling of guns, to provide instruction in marksmanship, and to encourage good sportsmanship among its members.

The organization's membership includes Regular Members (those with Annual, Life, Endowment Memberships) and Special Members. The Bylaws in effect for the year ending December 31, 20XX has a provision indicating that "Nonmembers belonging to a national trap, sporting clays or skeet association entered into a registered shoot shall, upon payment of the daily registration fee, be considered a member for that day". There was also a separate provision allowing nonmembers in general to become members for a day by paying a daily membership fee of \$.

The events the organization regularly conducts includes motto Classes. In addition the organization hosts registered shoots and the Annual WTA State Shoot, which is described in their newsletter publication as the fifth largest event in the U.S.

In conducting the audit, the IRS, inquired into the revenues generated by the Special Class of members. Including all required sources of support for the year (dues, entry fees, inventory/food sales, et cetera), these members were responsible for % of the gross receipts received by the club in the year ending December 31, 20XX, not including income from the WTA State Shoot. Except for the WTA State Shoot, the organization indicated that the percentages and the levels of income would be the same for all years surrounding the year under examination.

In terms of the WTA State Shoot the following was noted: First, the gross receipts reported from the WTA State Shoot were reported net (\$k was reported on the 990 vs. the \$k that was collected from the event; the organization provided revised analysis indicating that the income from the event was \$k. It is not known exactly how this number was reduced by the organization i.e. whether they deducted moneys paid to the WTA... whatever the case may be for purposes of this analysis \$k was used. Any differences in figures would be on the same proportional basis: Per analysis submitted % of income was from the Special Member Class). Secondly, factoring in the gross receipts from this event raises the percentage of gross receipts received from nonmembers from % to %.

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In prior years ORG, received a rental payment for hosting the WTA State Shoot. Years 20XX - 20XX mark the only years in which they have been under contract to run the event and thereby collect all the receipts from the event, provide staffing, et cetera. The prior year return filed for the year ending December 31, 20XX reports that the organization received a rental payment of \$. ORG indicated, that the existing contract with WTA ends in 20XX. Thus they have the flexibility after this year to change their involvement with the event.

The organization reportedly also did away with the daily memberships in the calendar-year 20XX and went to another format of limited memberships.

In terms of the overall (including receipts from members and nonmembers) profitability of the different events, the Profit and Loss Statement for the WTA State Shoot as provide by the Club shows a Net Profit of \$. The Profit and Loss Summary for Merchandise and Food and Beverage Sales as provided by the Club shows a Gross Profit of \$. The Gross Profit for the Shooting Events overall as provided by the Club in its Cost Allocation Analysis (excluding Gross Profit from the WTA State Shoot) shows a Gross Profit of (\$). However, the Gross Profit calculation for the regular shooting events includes an allocated cost of depreciation for (\$). It would be argued that depreciation is a fixed cost for assets purchased for the club. Members would ordinarily bare the costs of depreciation. Upon dissolution any net assets of the club would be distributable to members, thus for purposes of this analysis depreciation would not be considered. The same argument would be made for the general costs of liability insurance (Health, Liability and Workers Compensation was deducted in full in the amount of \$). An argument could be accepted that portions of this would be a direct cost as it relates to the health and liabilities for workers staffing events. However, any costs relating to liability insurance directed towards the property of the club, et cetera would have to be excluded.

Overall there are several issues noted from the analysis of the ORG: (1) In terms of income from Special Members, receipts from these individuals, whether upon paying a daily membership fee and/or belonging to another club of like nature, are receipts from nonmembers per the rules and regulations governing organizations exempt under IRC Section 501(c)(7). (2) Not even factoring in the WTA State Shoot, the organization substantially exceeds the gross receipts limitation from nonmembers. (3) Furthermore the events are producing gross profits, thus the nonmembers participation in these events, subsidizes fixed costs members would ordinarily have to bare alone.

Therefore based on the law and even the facts and circumstances, it can only be concluded that the organization has operated in a manner inconsistent from IRC Section 501(c)(7), and that being so, their exempt status should be revoked effective January 1, 20XX.

Law:

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IRC Section 501(c)7 states (in specifying attributes for exemption):

“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.”

Treasury Regulation Section 1.501(c)7-1, further expounds upon Internal Revenue Code Section 501(c)(7), by indicating that a club engaging in business, is not operated exclusively for pleasure, recreation, or social purposes. An example given by the regulation to indicate the presence of a business operation, included the solicitation of public patronage by advertisement.

Revenue Ruling 58-588, 1958-2 C.B. 265, provides that a social club who sells an unlimited number of memberships to so-called “members”, who have no voice in the management of the club and whose only rights are to use the club’s facilities upon payment of specified fees, is not a tax-exempt social club within the meaning of IRC Section 501(c)(7). It was also found in this case that the Club used the “associate memberships” designation as a guise to circumscribe the rules regarding social clubs and income from nonmembers. (In this case the predominant activity of the club was selling these memberships which is a noted distinguishing factor from the Waukesha Gun Club).

Revenue Ruling 58-589, 1958-2 C.B. 266, provides that operational costs covered by nonmember patronage, would be an indicator of inurement, provided the club’s assets are distributable to club members upon dissolution. The effect of this Ruling is that a club can overall experience a loss in any given business year, but inurement can take the form of any excess of nonmember receipts over direct costs, covering expenses that the members of the club would have to bare if it were not for the income provided by nonmember patronage.

Revenue Ruling 1960-324, 1960-2 C.B. 173, weighed the following factors in its findings that a club that makes its facilities available to the general public on a regular, recurring, basis should no longer be recognized under IRC Section 501(c)(7): percentage of nonmember gross receipts (ranged from 12-17% in this case), gross profit from the unrelated activities, net profit overall and the number of outside (unrelated) functions compared to total functions of the club. It was also indicated that internal analysis of the club showed that if these outside activities were discontinued, a substantial increase in the amount of annual dues from club members would be necessary.

Revenue Ruling 1967-428, 1967-2 C.B. 204, provides that a federation of clubs is not exempt under IRC Section 501(c)(7). Commingling, a material aspect of an exempt social club, is

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recognized on the individual club level. Fellowship between members however does not play a material part in the activities of an organization composed of artificial entities.

Revenue Ruling 1979-145, 1979-1, C.B. 360, provides that in the calculation of the wagering tax, that a guest of a nonprofit social club is an individual who is a guest of a member of the club and who ordinarily does not reimburse the member for the guest's expenses. On the other hand, 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. This Revenue Ruling refers to Revenue Procedure 1971-17, in stating that members of other social clubs are members of the general public.

Revenue Procedure 1971-17, 1971-1, CB 683, sets forth the guidelines for determining the gross receipts from the use of a social club's facilities by the general public. The Revenue Procedure also provides that in situations 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. The definition of items includable in the gross receipts tests is established in this Revenue Procedure. Also contained in this Revenue Procedure are the rules under which the host-guest relationship will be established.

U.S. Court of Appeals:

Pittsburgh Press Club v. USA, 536 F.2d 572, (1976).

Case stated there are factors to be considered when considering the effects of a social club's nonmember receipts, including the percentage of gross receipts from nonmembers, profit from non-member receipts, the purpose for which a social club's facilities are made available to nonmember groups, and the frequency of use of club facilities made by nonmembers.

Public Law -PL 94-568(October 20, 1976):

This Public Law defines limitations of nonmember gross receipts as 15% of total gross receipts.

Government's Position:

Social Clubs receiving more than % of their receipts from nonmembers are not operating in an exempt fashion per the rules and regulations governing organizations exempt under IRC Section 501(c)(7), with limited exceptions.

Nonmember receipts as established by Revenue Rulings 1958-588, includes receipts from individuals that have no voice in the management of the club and whose only rights are to use

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club facilities upon payments of specified fees. Revenue Rulings 1967-428 and 1979-145 provide that receipts from members of clubs, even of like nature, are receipts from nonmembers.

Therefore the receipts ORG, receives from Special Members and/or Daily Members, whether or not they are members of other social clubs (or other organizations), are gross receipts from nonmembers.

At the very least ORG, exceeds the gross receipts test by %. At the most ORG exceeds the gross receipts test by %. In terms of the facts and circumstances tests described in Revenue Rulings 1960-324 and City Press Club v. USA, the ORG exceeding the gross receipts tests by either percentage is unfavorable. In Revenue Ruling 1960-324, the club in that case only exceeded the percentage by two percent at the most (% of nonmember income over several years). The Social Club described in Revenue Ruling 1960-324 had their exemption revoked.

The ORG, describes their club as a club that operates at a deficit. However, as noted in Revenue Ruling 1958-589, 1960-324, one must weigh whether or not nonmember receipts cover fixed costs that members would have to bare if it were not for the receipts derived from non-members. In analyzing the 990 and other information furnished by the club for the year ending December 31, 20XX it is determinable that overall when excluding fixed costs such as Depreciation, Insurance to an extent, Property Taxes, et cetera that Gross Profits from the events are being produced.

Overall the primary distinguishing factor between the ORG, and rules regarding situations were the gross receipts test can be excepted is its level of Gross Receipts from non-members. Taken into account activities outside of the WTA State Shoot, the nonmember gross receipts percentage is still%. This level of nonmember gross receipts indicates that the club is not substantially member driven in activities and income. Factoring in the WTA State Shoot further compounds the issue by showing that the club, at least under their current contract with the WTA (20XX-20XX), is operating in a manner where more then % of their receipts are from nonmember sources.

Taxpayer's Position:

ORG indicated that it was willing to change its involvement with the WTA State Shoot after the year ending December 31, 20XX. They also indicated they were not aware of the Host-Guest Relationship Rules detailed in Revenue Procedure 1971-17. It was indicated that there were situations were members paid for guests, but such income would have been inadvertently accounted for as nonmember income.

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The organization reiterated that it has operated at a net loss every year (Overall net loss for 20XX was \$). It was also indicated that the organization is active in the community through its annual shoot for Cystic Fibrosis (proceeds are distributed for charitable purposes), other donations and conducting of motto Classes.

Conclusion:

All the facts have been considered and it's been determined that the organization has not met the requirements for continued exemption as a 501(c)(7) organization.

Although the organization has not produced net income overall, the costs that members would have to bare alone, are being subsidized through nonmember patronage. It can be argued that without the level of nonmember income the organization has received, that the losses would be substantially higher.

Also the gross receipts test shows that the organization has exceeded permissible levels to a substantial degree. No precedent was noted that discussed facts and circumstances of a Social Club's continued exemption, where nonmember patronage was not within a few percentage points of %. The club's argument about the Host-Guest relationship is understood, however nothing has been produced to evidence that where the Host-Guest relationship was properly observed, the level of nonmember receipts would be substantially reduced.

The organization's exempt status should be revoked effective January 1, 20XX, the date the material change in exemption was first noted. Rev. Proc. 84-46, 1984-1 C.B. 541.