



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
TE/GE EO EXAMINATIONS  
1100 COMMERCE ST. MAIL CODE 4920 DAL  
DALLAS, TEXAS 75242

Number: **201330041**  
Release Date: 7/26/2013

Date: August 13, 2011

LEGEND;  
ORG – Organizations Name  
Xx - Date  
Address-Address

**Employer Identification Number:**

**Person to Contact/ID Number:**

**Contact Numbers:**

ORG  
ADDRESS

Voice  
Fax

UIL: 501.07-00

**CERTIFIED MAIL – RETURN RECEIPT REQUESTED**

Dear :

In a determination letter dated July 19xx, you were held to be exempt from Federal income tax under section 501(c)(7) of the Internal Revenue Code (the Code).

Based on recent information received, we have determined you have not operated in accordance with the provisions of section 501(c)(7) of the Code. Accordingly, your exemption from Federal income tax is revoked effective April 1, 20xx. This is a final adverse determination letter with regard to your status under section 501(c)(7) of the Code.

We previously provided you a report of examination explaining why we believe revocation of your exempt status is necessary. At that time, we informed you of your right to contact the Taxpayer Advocate, as well as your appeal rights. On May 26, 20xx, you signed Form 6018-A, *Consent to Proposed Action*, agreeing to the revocation of your exempt status under section 501(c)(7) of the Code.

You have filed taxable returns on Forms 1120, *US Corporation Income Tax Return*, for the years ended March 31, 20xx, and March 31, 20xx with us. For future periods, you are required to file Form 1120 with the appropriate service center indicated in the instructions for the return.

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:

Taxpayer Advocate Service

If you have any questions, please contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely,

Nanette M. Downing  
Director, EO Examinations

**Internal Revenue Service**  
Tax Exempt and Government Entities Division  
Exempt Organizations: Examinations

**Department of the Treasury**

Date: May 13, 2011

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Legend:

ORG –Name of Organization

XX – Date

Address- address

Contact Numbers:

Telephone:

Fax:

**Certified Mail – Return Receipt Requested (Hand delivered)**

Dear \_\_\_\_\_ :

We have enclosed a copy of our report of examination explaining why we believe revocation 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-A, *Consent to Proposed Adverse Action*. We will then send you a final letter revoking your 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:

Internal Revenue Service

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,

Nanette M. Downing  
Director, EO Examinations

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

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
<b>Name of Taxpayer</b>  <b>ORG</b> Form 990		<b>Year(s)/Period</b> <b>Year1, Year2</b>
	<b>EIN</b>	

Legend:

ORG – Name of Organization    Address = Address    Xx – Date    State -State

ISSUE(S):

Does the ORG., receive significant nonmember revenues to warrant revocation of its IRC 501(c)(7) Federal tax exempt status?

FACTS:

This examination was conducted initially for the fiscal year ended March 31, 20xx, and was expanded to include year ended March 31, 20xx. Examination activity included interviews, tour of facility, and examination of books and records for the purpose of determining whether there exists sufficient exempt activity to retain exemption, compliance with filing requirements, adequate record-keeping and proper reporting of any unrelated business activity. In addition, this examination sought to determine if there exists a sufficient nonmember element to warrant revocation of exemption in accordance with the requirements set forth in Revenue Procedure 71-17 as modified by Committee Reports for Public Law 94-568 relative to IRC Section 501(c)(7) organizations. If nonmember participation is evident, but not to the extent which would warrant revocation of exemption, the examination would determine the extent of any unrelated business income from nonmember activity and also the amount of unrelated business income tax due from the organization.

The ORG., incorporated in the State per Articles of Incorporation filed with the Secretary of State on December 28, 19xx. ORG submitted application for and received Federal tax exempt status under Internal Revenue Code Section 501(c)(7), in original ruling of July 19xx, for the purpose of providing social and recreational activities to it's membership. The ORG occupies approximately four floors within the Building, located at address.

Service records indicate ORG is required to file Form 990, Return of Organization Exempt From Income Tax, Form 990-T, Exempt Organization Business Income Tax Return, Form 941, Employer's Quarterly Federal Tax Return, and Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return. All federal returns were shown to be filed timely.

Per information provided in interviews with club managers, the primary activity provided by the Club is the sales of food and beverage to it's membership, specifically lunch and dinner. Other activities include Saturday night dances, weddings, parties, books reviews, fashion shows, bridge club, cigar and bourbon tasting, various educational

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer  <b>ORG</b> Form 990		Year(s)/Period Year1, Year2
EIN		

activities, holiday buffets, and an annual golf tournament. During the interview, inquiry was made regarding the extent of any nonmember participation in any of the club activities. During the interview, It was disclosed weddings and wedding related activities were open to nonmembers of the general public. There was also evidence that the organization engaged in significant promotions and advertising of it's wedding services on the internet to include it's own website. The internet website for ORG specifically indicates "Non-members welcome" on it's "Weddings" page.

The Club also entered into several reciprocal agreements with other clubs allowing members of those clubs to utilize their facilities while allowing ORG members to use the facilities of the club ORG had agreements with. ORG received revenues from these "nonmembers" primarily from sales of food and beverages.

Financial Information pertinent to addressing the requirements of Public Law 94-568, H.R. 1144 Senate Report 94-1318, Section II(A)(4) For IRC 501(c)(7) Organizations - 35/15 Percent Test of Nonmember/Investment Income for Exemption Retention are as follows:

	FYE	FYE
	<u>3/31/20xx</u>	<u>3/31/20xx</u>
Total Gross Receipts (*see note)		
Investment Income		
Nonmember Income (**see below for explanation)		
<b>Percent Test</b>		
Percentage of nonmember income (Including investment income)	%	%
to total income (investment income plus nonmember income divided by total gross receipts).		
<b>Percent Test</b>		
Percentage of income from nonmember/general public's use of facilities/services (Nonmember income divided by total gross receipts)	%	%

\*Note - does not include initiation fees, capital contributions, interest, dividends, rents, and similar receipts, or unusual nonrecurring sales of club assets.

\*\*Description of Nonmember Income:

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
<b>Explanation of Items</b>		
<b>Name of Taxpayer</b>		<b>Year(s)/Period</b>
<b>ORG</b>	Form 990	<b>Year1, Year2</b>
	EIN	

Nonmember income consists of nonmember receipts from weddings and other social/recreational activities on the club premises and also revenues from other clubs with which taxpayer has a reciprocal agreement.

The total nonmember income amounts above include \$ in revenues from nonmember weddings and other social events for FYE's ended 3/31/20xx and 3/31/20xx respectively. In addition, total nonmember income amounts also include \$ and \$ in revenues from reciprocal club agreements for FYE's ended 3/31/20xx and 3/31/20xx respectively.

During the examination, it was determined that the Club complied with the record-keeping requirements of Revenue Procedure 71-17, 1971-1 C.B. 683. However the Club receives income from outside its membership. Based on examination of the Club's Form 990 return for the period ending March 31, 20xx, and March 31, 20xx, and review of their books and records, the percent of gross receipts from nonmember use of facilities exceeded % for the year of the exam as well as in the subsequent year, while investment income was less % for both years.

**LAW:**

Organizations exempt from federal taxes as described in IRC Section 501(c)(7) include clubs organized for pleasure, recreation, and other non-profitable 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 of the Income Tax Regulations, relating to the requirements of exemption of such clubs under section 501(a), reads in part as follows:

(a) The exemption provided by section 501(a) for organizations described in section 501(c)(7) applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, but does not apply to any club if its net earnings inures to the benefit of any private shareholder. In general, this exemption extends to social and recreation clubs which are supported solely by membership fees, dues, and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenue from members through the use of club facilities or in connection with club activities.

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
<b>Name of Taxpayer</b>  <b>ORG</b> Form 990		<b>Year(s)/Period</b> <b>Year1, Year2</b>
EIN		

(b) A club which engages in business, such as making its social and recreational facilities available to the general public or by selling real estate, timber or other products, is not organized and operated exclusively for pleasure, recreation, and other non-profitable 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 is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes. However, an incidental sale of property will not deprive a club of its exemption.

Prior to its amendment in 1976, IRC Section 501(c)(7) required that social clubs be operated exclusively for pleasure, recreation, and other non-profitable purposes. Public Law 94-568 amended the "exclusive" provision to read "substantially" in order to allow a section 501(c)(7) organization to receive up to 35 percent of its gross receipts, including investment income, from sources outside its membership without losing its tax exempt status. The Committee Reports for Public Law 94-568 further state:

- (a) Within this 35 percent amount, not more than 15 percent of the gross receipts should be derived from the use of a social club's facilities or services by the general public. This means that an exempt social club may receive up to 35 percent of its gross receipts from a combination of investment income and receipts from non-members, so long as the latter do not represent more than 15 percent of total receipts. These percentages supersede those provided in Revenue Ruling 71-17, 1971-1 C.B. 683.
- (b) Thus, a social club may receive investment income up to the full 35 percent of its gross receipts if no income is received from non-members' use of club facilities.
- (c) In addition, the Committee Reports state that where a club receives unusual amounts of income, such as from the sale of its clubhouse or similar facilities, that income is not to be included in the 35 percent formula.
- (d) The Senate report also indicates that even though gross receipts from the general public exceed this standard, it does not necessarily establish that there is a nonexempt purpose. A conclusion that there is a nonexempt purpose will be based on all the facts and circumstances including, but not limited to, the gross receipts factor.

Revenue Ruling 58-589 sets forth the criteria for exemption under section 501(c)(7) of the Code, and provides that a club must have an established membership of individuals, personal contacts, and fellowship. It also provides that, while the regulations indicate that a club may lose its exemption if it makes its facilities available

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
<b>Name of Taxpayer</b>  <b>ORG</b> Form 990		<b>Year(s)/Period</b> <b>Year1, Year2</b>
EIN		

to the general public, this does not mean that any dealings with nonmembers will automatically cause a club to lose its exemption. A club may receive some income from the general public, that is, persons other than members and their bona fide guests, or permit the general public to participate in its affairs, provided that such participation is incidental to and in furtherance of the club's exempt purposes, such dealings with the general public and the receipt of income therefrom does not indicate the existence of a club purpose to make a profit, and the income does not inure to club members.

Revenue Ruling 60-324 provides that a social club that made its social facilities available to the general public through its member-sponsorship arrangement can not be treated as being operated exclusively for pleasure, recreation, or other non-profitable purposes and the club no longer qualified for exemption under 501(c)(7) of the Code.

Revenue Ruling 66-149 provides that a social club is not exempt from federal income tax as an organization described in section 501(c)(7) of the code if it regularly derives a substantial part of its income from non-member sources such as, for example, dividends and interest on investments.

Revenue Ruling 68-119 provides that a club will not necessarily lose its exemption if it derives income from transactions with other than bona fide members and their guests, or if the general public on occasion is permitted to participate in its affairs, provided such participation is incidental to and in furtherance of its general club purposes and the income therefrom does not inure to members.

Revenue Procedure 71-17 sets forth guidelines for determining the effect of gross receipts derived from nonmember use of a social club's facilities on exemption under Internal Revenue Code Section 501(c)(7) and recordkeeping requirements. Failure to maintain such records or make them available to the Service for examination will preclude use of the minimum gross receipts standard and audit assumptions set forth in this Revenue Procedure.

If a club exceeds the 15/35% test, then it will maintain its exempt status only if it can show through facts and circumstances that "substantially all" of its activities are for "pleasure, recreation and other non-profitable purposes."

The following are important facts and circumstances to take into account to determine whether a club may maintain its exemption under IRC 501(c)(7):

- The actual percentage of nonmember receipts and/or investment income.

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
<b>Name of Taxpayer</b>  <b>ORG</b> Form 990		<b>Year(s)/Period</b> <b>Year1, Year2</b>
EIN		

- Frequency of use of the club facilities or services by nonmembers. An unusual or single event (that is, nonrecurring on a year to year basis) that generates all the nonmember income is viewed more favorably than nonmember income arising from frequent use by nonmembers.
- Record of nonmember use over a period of years. A high percentage in one year by nonmembers, with the other years being within permitted levels, is viewed more favorably than a consistent pattern of exceeding the limits, even by relatively small amounts. (See S. Rept. 94-1318, 2d Sess., 1976-2 C.B. 597,599).
  - Purposes for which the club's facilities were made available to nonmembers.
  - Whether the nonmember income generates net profits for the organization. Profits derived from nonmembers, unless set aside, subsidize the club's activities for members and result in inurement within the meaning of IRC 501(c)(7).

#### GOVERNMENT'S POSITION:

An organization exempt from federal income taxes as described in IRC section 501(c)(7) must meet the gross receipts test in order to maintain its exemption. In order to meet the gross receipts test, an organization can receive up to thirty-five percent (35%) of its gross receipts, including investment income, from sources outside its membership without losing its tax exempt status. Within this 35% amount, not more than fifteen percent (15%) of the gross receipts should be derived from the use of a social club's facilities or services by non-members.

ORG has exceeded the 15% gross receipts standard for nonmember income on a continuous basis for the two consecutive years under examination. The nonmember receipts are earned throughout the year. There was no one single or unusual event that caused the club to exceed the 15% threshold.

Based on the large percentages of gross nonmember income to total gross receipts of the club, which exceeds the limitation of 15% as set forth by IRC 501(c)(7) for each of these years and the fact that it advertises the use of its facilities to the public, it is the Government's position that the Club is no longer operated exclusively for the pleasure and recreation of its members and is not exempt under section 501(c)(7).

#### TAXPAYER'S POSITION:

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
<b>Name of Taxpayer</b>  <b>ORG</b> Form 990		<b>Year(s)/Period</b> <b>Year1, Year2</b>
EIN		

The Club has agreed to the proposed revocation of their tax exempt status as described in IRC section 501(c)(7).

**CONCLUSION:**

The IRC Section 501(c)(7) tax exempt status of ORG., should be revoked since the nonmember income received by the Club exceeded 15% of the Club's total gross receipts for the years under examination. Further, it advertises the use of their facilities to the general public reflecting evidence that the Club is engaged in a business and is not being "operated exclusively for pleasure, recreation, or social purposes" of its membership.

ORG., no longer meets the requirements to qualify as exempt from federal income tax under IRC section 501(a) as described in section 501(c)(7). Therefore, exemption under 501(c)(7) of the Internal Revenue Code will be revoked effective April 1, 20xx.

As a taxable entity, the organization is required to file Form 1120, U.S. Corporation Income Tax Return for the periods open under statute. Under 6501(g) these periods include the years ending March 31, 20xx, and subsequent tax years.

Additionally, the organization is reminded of the provisions of IRC 277 concerning membership organizations which are not exempt organizations.

A closing conference was offered to and conducted with officials of ORG.