



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
Attn: Mandatory Review, MC 4920 DAL
1100 Commerce Street
Dallas, TX 75242

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

UIL: 501.07-01

Date: December 16, 2013

Release Number: **201337017**
Release Date: 9/13/13
Legend;
ORG = Name of Organization
ADDRESS = Address of Organization
Year = XX

Employee Identification Number:
NUM

Person to Contact/ID Number:

ORG
ADDRESS

Contact Numbers:
Telephone:
Fax:

Certified Mail – Return Receipt Requested

Dear

In a determination letter dated January 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 January 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 Tax Payer Advocate, as well as your appeal rights. On November 16, 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 are therefore required to file the Form 1120, U.S. Corporation Income Tax Return, for the years ended 12/31/20xx through 12/31/20xx with the Ogden

Service Center. 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:

Internal Revenue Service
Office of the Taxpayer Advocate

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

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer ORG	Tax Identification Number NUM	Year/Period ended 20xx12 & 20xx12

LEGEND:

ORG = Name of Organization
 NUM = EIN number of Organization
 State = Name of State
 Date = xx

Issue:

Whether ORG, will continue to qualify as an exempt social club under 501(c)(7) of the Internal Revenue Code?

Facts:

The ORG, was granted exemption in 19xx as an organization described under section 501(c)(7) of the Internal Revenue Code. The Articles of Incorporation state its purpose is to encourage social and athletic activities among members and to participate in social and athletic affairs of State.

During the examination the organization's Treasurer indicated that the main activity of the organization was the operation of a restaurant and the rental of its banquet hall to its 59 members. Treasurer also stated that, in addition to the restaurant and hall rental activities, the organization also hosts dinner events for Easter, Mother's Day, Father's Day, Thanksgiving and a New Years Gala. It was also disclosed that the restaurant is open for members Wednesday through Saturday from 5pm to 7:30pm and Sunday from 1:30pm to 7pm. Treasurer indicated that members gain entrance based on their issued identification cards; however, since the officers are acquainted with all the members they do not need to show it upon entrance.

It was further indicated that the organization lets other not-for-profit clubs utilize their banquet halls for parties and events. During the tax year ending December 31, 20xx, the club allowed use of their facilities for the Festival by the East Coast Museum and for another Festival by the Dancers of State. (See Exhibit 1 through 6.) The club also provides food and drinks as part of the rental agreement. Revenue from admission for these events is split between the sponsoring organization and the club. Revenue collected from these events is used to cover the costs of food, beverages and hall rental. These events are also posted on the website of the sponsoring organizations, opening the events to members of that club and to the general public. Further internet research conducted indicates that these events have taken place at the ORG since 20xx and continue to present.

Supporting documentation was requested in order to determine that the organization was maintaining proper records to distinguish between member and non-member income for the \$0 reported as gross revenue on the Form 990. For the tax year ending December 31, 20xx, the organization did not have any receipts or daily cash register tapes for restaurant sales, they did not maintain any records to distinguish between member and non-member patrons at the restaurant, there were no invoices to support expenditures made with cash or by check, there were no hall rental agreements and there were no books of account for income or expenditures. The only information available for review were cancelled checks, bank statements, news letters, flyers and minutes of meetings.

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer ORG	Tax Identification Number NUM	Year/Period ended 20xx12 & 20xx12

The flyer that was available for review advertised for restaurant/party services. (See Exhibit 7.) The flyer provided the name and address of the organization, the name of the manager and listed the buffet and dinner selections. Thirteen hot buffet selections and ten cold dishes are listed on the flyer. Dinner included soup and drinks with eleven meal selections. The flyer stated that buffet and dinner prices are available upon request and the same applies to liquor prices. It also stated that taxes and gratuities will be added to the total bill. The flyer did not include a statement that this establishment was for members only.

The examination was then expanded to include the tax year ending December 31, 20xx. Again, the same activities were conducted as in the prior year. The organization operated a restaurant and rented out their hall to their, now, 44 members. They also hosted another Museum Event, and events with the Dancers of State. (See Exhibit 1 through 6.) Again, revenue from admission was split between the sponsoring organizations and the club.

The gross revenue reported on the Form 990 for the tax year ending December 31, 20xx was \$0. Although the organization did have the daily cash register tapes to substantiate the sales at the restaurant, they did not account or keep record of member and non-member sales. The cash receipt tapes only documented the number of guests, the cost of the meal, beverages, liquor and sales tax. Attached to the tape, if available, was an invoice for any expenses related to the restaurant that was paid in cash. The club still did not maintain hall rental agreements and all invoices for expenditures incurred that were paid by check.

In addition, research conducted on the internet displayed reviews by patrons who appear not to be members eating at the restaurant. One review, dated October 10, 20xx and posted on club.com, described the club and described the food being served for that evening. The review also suggested calling in advance in case there was an event going on. (See Exhibit 8.) Another review, dated April 28, 20xx and posted on another .com indicated that the restaurant was open to the public and that the food was great and reasonably priced. (See Exhibit 9.) In a news article entitled "Cook" dated May 9, 20xx from www., the author interviewed the manager of the club. Manager discussed her history with the club and the types of food served. The author also noted how many patrons were dining in the club that day. There was no mention in the article that the club was open to members only. (See Exhibit 10.) Another news article in the News dated March 17, 20xx described the food served at the restaurant and included comments from various patrons. There was no mention in the article that the club was open to members only. (See Exhibit 11.) A third article in the Paper dated February 21, 20xx, referenced the ORG. as a public restaurant. (See Exhibit 12.)

Law:

Internal Revenue Code §501(c)(7) exempts from federal income tax 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

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS		Schedule number or exhibit
Name of taxpayer ORG	Tax Identification Number NUM	Year/Period ended 20xx12 & 20xx12	

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.

(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.

Public Law 94-568 amended IRC 501 to reflect a twofold change under IRC 501(c)(7). First, it makes it clear that a social club may receive some investment income without losing its exempt status. Second, it permits a higher level of income from nonmember use of club facilities than was previously allowed.

In addition, Public Law 94-568 defines gross receipts as those receipts from normal and usual activities of a club including charges, admissions, membership fees, dues, assessments, investment income, and normal recurring capital gains on investments, but excluding initiation fees and capital contributions. Public Law 94-568 also states that it is intended that social clubs be permitted to receive up to 35 percent of their gross receipts, including investment income, from sources outside of their membership without losing their exempt status. Within this 35 percent amount, not more than 15 percent of the gross receipts should be derived from the use of the social club's facilities or services by the general public. Thus, a social club may receive investment income up to the full 35 percent amount of gross receipts. If a club receives unusual amounts of income, such as from the sale of its clubhouse or similar facility, that income is not to be included in the 35 percent formula; that is, unusual income is not to be included in the gross receipts of the club.

Revenue Procedure 71-17, 1971-1 C.B. 683, provides that a social clubs must maintain specific records as to the use of its facilities in order to substantiate a host/guest relationship for determining member versus non-member usage. Failure to maintain such records may result in all income derived from such usage to be deemed from non-member sources and threaten continued exempt status.

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 to the general public, this does not mean that any dealings with non-members 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 there from 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, 1960-2 CB 173 concluded that a club making 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 nonprofitable purposes. Accordingly, it is held that the club

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS		Schedule number or exhibit
Name of taxpayer ORG	Tax Identification Number NUM	Year/Period ended 20xx12 & 20xx12	

no longer qualifies for exemption from Federal income tax under section 501(c)(7) of the Code.

Taxpayer's Position:

The taxpayer's Position is not yet known.

Government's Position:

It is the government's position that the tax exempt status of the ORG under section 501(c)(7) of the Internal Revenue Code be revoked for failing to maintain records to substantiate between member and non-member income and by making its restaurant available to the general public.

As indicated in Revenue Procedure 71-17 your organization must maintain records to substantiate events where non-members were permitted to attend or participate in the activities of your organization. During the examination, your organization was unable to provide records to distinguish member from non-member usage of your restaurant facility. For the years under examination, you did not keep any records which included the date of the transactions, the total number in the party, the number of non-members in the party, the total charges, the charges attributable to non-members, and charges paid by non-members. If a member was reimbursed for charges paid by non-members your organization was required to maintain a written statement by that member. Therefore, it can not be determined if your organization was within the 15% non-member income limitation as described above in Public Law 94-568. Since we can not determine whether your income for the tax years ending December 31, 20xx and 20xx were in fact from members, all income will be treated as non-member income.

Section 1.501(c)(7)-(1)(b) of the Income Tax Regulations states in part that, a club which engages in business, such as making its social and recreational facilities available to the general public, 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 club facilities is prima facie evidence that the club is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes.

During the years under examination, your organization allowed other not-for-profit organizations to utilize your club facilities. These other not-for-profit organizations posted these events on their website opening up the event to their members and the general public. Reviews of your restaurant were found on the internet and newspaper articles indicating that your facilities were being utilized by the general public. These reviews did not state the patronage was limited to members. One review indicated the club was open to the general public. Similar to the Treasury Regulation Section 1.501(c)(7)-(1)(b), above, your facilities are open to the general public and your organization solicits public patronage by advertising. This is prima facie evidence that your organization is not organized and operated exclusively for pleasure, recreation and other non-profitable purposes.

Conclusion:

Accordingly, we propose to revoke your exempt status under Internal Revenue Code section 501(c)(7), effective January 1, 20xx.