



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

**DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE**

**1100 Commerce St.  
Dallas, TX 75242**

**Number: 201448021**  
Release Date: 11/28/2014

**Date: February 25, 2009**

**Employer Identification Number:**

**Person to Contact/ID Number:**

**Contact Numbers:**

Voice:

Fax:

**UIL: 501.07-00**

**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 Taxpayer Advocate, as well as your appeal rights. On August 22, 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 Form(s) 1120, US Corporation Income Tax Return, for the year(s) ended December 31, 20XX, December 31, 20XX, and December 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:

South Dakota - Aberdeen

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

Sincerely,

Vicki L. Hansen  
Acting Director, EO Examinations

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>Year/Period Ended</b> December 31, 20XX

**ISSUES:**

ISSUE 1: Whether the \_\_\_\_\_ is still qualified to be exempt under Section 501(c)(7) of the Internal Revenue Code(IRC)?

ISSUE 2: Whether the revocation of the organization's tax-exempt status should be applied retroactively to tax year beginning January 1, 20XX?

**FACTS:**

\_\_\_\_\_ is an exempt organization located in \_\_\_\_\_. The organization's main activities are to "operate a recreational club which promotes the safety, skill, and enjoyment of sport parachuting". Although the organization was granted exempt status in \_\_\_\_\_, the location of the exempt activity is at \_\_\_\_\_ at an airfield owned by the \_\_\_\_\_. The organization was granted its exempt status in January 19XX as an exempt organization under section 501 (c )(7) of the Internal Revenue Code. The letter of exemption explained that a "section 501 (c) (7) is permitted to receive up to 35 percent of its gross receipts, including investment income, from sources outside of its membership without losing its tax exempt status". The letter further explained that "If your organization's character, method of operation, or purposes change, please let us know so we can consider the effect of the change on your organization's exempt status".

The organization operated as an organization under the name of \_\_\_\_\_, with a website named \_\_\_\_\_. This website solicited individuals to purchase \_\_\_\_\_ packages, classes, and \_\_\_\_\_. The website also explained their activity as follows: "we have been in operation as \_\_\_\_\_ since the early 19XX's. We recently changed our organization's name to \_\_\_\_\_ to better reflect our regional identity". In addition to the packages available for purchase, the website also discussed the annual "\_\_\_\_\_ " held over the Fourth of July weekend. This income has been a source of income for tax years 20XX through 20XX. For tax year ending December 31, 200XX, a review of the sources of income was not performed since the organization has filed an extension to file the Form 990.

In addition to the website, the organization advertised in the local phone book by referencing the website of \_\_\_\_\_

The organization had \_\_\_\_\_ members in tax year 20XX, with each member paying yearly dues of \$ \_\_\_\_\_ per year. In addition to the yearly dues, the members pay for \_\_\_\_\_ done with other individuals based on the number of participants and the \_\_\_\_\_. The organization's source of income for its members in tax year 20XX per the books and records was \$ \_\_\_\_\_ for dues and \$ \_\_\_\_\_ for member jumps. The remaining income from the organization was \$ \_\_\_\_\_ from non-members and \$ \_\_\_\_\_ from investments.

**LAW:**

Section 501 (c) (7) of the Code (IRC) defines an exempt organization under this section as one that is organized for the pleasure, recreation, and other nonprofit purposes, for its members.

Section 1.501(c)(7)-1 of the Income Tax Regulations provides that, in general, the exemption extends to social and recreation clubs which are supported by membership fees, dues, and assessments. However, 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).

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**Revenue Procedure 71-17** as amended by **Public Law 94-568** provides certain gross receipts safe harbors; i.e. Social Clubs may receive up to 35% of their total gross receipts, including investment income, from sources outside of their membership without jeopardizing their tax-exempt status. Within this 35% limit, no more than 15% of a club's gross receipts may be derived from nonmember use of the club's facilities and/or services. If these standards are exceeded, a Social Club will not qualify for exemption pursuant to IRC section 501(c)(7).

Under **Revenue Ruling 68-638, 1968-2**, the court ruled that a country club organized for the promotion and enjoyment of golf and other sports for its members was not exempt under Section 501 (c )(7) of the Code. The club engaged in golf tournaments that attracted large numbers of spectators. During the tournaments, the club received substantial receipts from admission fees, broadcasting rights, parking fees, and food and beverage concessions. The net income received from the tournaments was used for capital improvements and club operating expenses. The Revenue ruling explained that this country club was not exempt for two reasons: (1) "it is engaged in business with the general public by hosting an annual golf tournament to which the public is admitted for a charge, and (2) income from the tournaments is inuring to the benefit of the members in the form of improved facilities and increased services".

**GOVERNMENT'S POSITION**

A review of the income reported in tax year 20XX showed the organization had the following income:

Type of Revenue	Form 990 as filed by organization 12/31/20XX	As adjusted for non-member income 12/31/20XX
<b>Member dues and assessments</b>	\$	
Member dues		\$
Member		\$
<b>Total member income</b>		<b>\$</b>
<b>Non-member income (as classified by Examiner)</b>		
Income		\$
Club Store		\$
Credit Cards		\$
Demos		\$
Gift Certificates		\$
Non-member		\$
Non-member services		\$
Observer Rides		\$
Paypal transfers		\$
Line Class:		
line class-deposit		\$
line class-Other		\$
Student (not college students, student )		\$
deposit		\$
Other		\$
Video W/Stills		\$

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Misc. Income \$

Un-Used deposits \$

**Total non-member income:** \$

**Total income from org. without investments:** \$

**Total member income:** \$

**Total non-member income:** \$

**Percentage of non-member income**

\$ /\$ %

**Percentage of member income**

\$ /\$ %

A review of the revenue for the prior year, December 31, 20XX, the current year being examined, along with the subsequent year, 20XX, showed the following revenue received by for members and non-members:

	EXAMINED YEAR			
	12/31/20XX	12/31/20XX	12/31/20XX	12/31/20XX
Program service revenue (member dues)	\$	\$	\$	\$
Non-member revenue	\$	\$	\$	\$
Total revenue	\$	\$	\$	\$
Member percentage	%	%	%	%
Non-member percentage	%	%	%	%
Exceeds 15% non-member revenue?	YES	YES	YES	

The safe harbor in Rev Procedure 71-17 as amended by Public Law 94-568, allows to receive only 15% of their receipts from members, and a total of 35% from investment income. A review of the Gross receipts received from members and non-member activities for tax years 20XX through 20XX showed the organization consistently received income that exceeded the allowable 15% from non-members. Since the amount received from non-members was greater than 15%, further review of the investment income received by the organization was not required to be calculated.

Issue 1:  
*Whether the* *is still qualified to be exempt under Section 501(c)(7) of*  
*the Internal Revenue Code?*

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A review of the income received by indicated more than 15% of the income was from non-members in tax year 20XX. The organization does not meet the requirements to be exempt under Section 501(c)(7) of the Code.

**Issue 2:**

*Whether the revocation of the organization's tax-exempt status should be applied retroactively to tax year beginning January 1, 20XX?*

The profit and loss statements provided for 20XX and 20XX show the organization has consistently exceeded the 15% allowed in income from non-members. Since the first year under examination is the year ending December 31, 20XX, it is the Government's position that the exempt status should be revoked back to January 1, 20XX.

**TAXPAYER'S POSITION**

The position of the taxpayer is unknown at this time.

**CONCLUSION**

**Based on the review of the income received by , the organization's exempt status should be revoked since its income exceeded the maximum 15% allowed under Section 501 (c )(7) of the Internal Revenue Code. The organization will file the annual Form 1120 beginning in the tax year January 1, 20XX through December 31, 20XX, and in all future tax years. The exempt organization will submit Forms 1120 for tax years ending December 31, 20XX, December 31, 20XX, and December 31, 20XX to the Revenue Agent.**

Per Section 277 of the Internal Revenue Code (Code), a non-exempt organization that is a membership organization is allowed a deduction for expenses that relate to the operation of the organization for its members. Section 277(a) states that "In the case of a social club or other membership organization which is operated primarily to furnish services or goods to members, and which is not exempt from taxation, deductions for the taxable year attributable to furnishing services, insurance, goods, or other items of value to members shall be allowed only to the extent of income derived during such year from members or transactions with members (including income derived during such year from institutes and trade shows which are primarily for the education of members)".

When completing the Form 1120 the organization must divide the income and expenses between the member and non-member activities. If there is a loss from the membership activity it cannot be used to offset the income from the non-member activities. A loss on the member activity can be carried forward to a later year to be taken against member income.