



Department of the Treasury  
Internal Revenue Service  
Mail Stop 1112, PO Box 12307  
Ogden, UT 84412

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Date:  
December 10, 2013  
Person to Contact/ID Number:  
  
Contact Numbers:  
Telephone: Toll Free  
Long Distance  
Fax:

Taxpayer Identification Number:  
Form: 990  
Tax Year(s) Ended: December 31, 20XX, December 31, 20XX, December 31,  
20XX

**Certified Mail - Return Receipt Requested**

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, *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:

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  
Report of Examination  
Envelope

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer  ORG		Year/Period Ended  December 31, 20XX

Date of Draft Notice: December 2, 20XX

**Issues**

- Whether the ORG's should remain a IRC 501(c)7 social club or be revoked of their tax exempt status.

**Facts**

The ORG applied to be a 501(c)7 Social Club in February 19XX. They received their tax exempt status in 19XX. However, the status was made retroactive to May 19XX.

The club owns and maintains a building located at Address in City, State. The club is open 7 days a week in the hours of 11:00 am to 12:00 pm.

The club has 150 members at the present time. The membership fee is \$0 per year per person. Senior Citizens pay a discounted rate of \$0 dollars each year.

On August 8, 20XX the taxpayer was contacted by a Tax Examiner with the Internal Revenue Service and informed that a compliance check was being conducted. The taxpayer was informed that they have filed Form 990 for the tax periods ending December 31, 20XX, and had reported investment and rental income, but had not filed Form 990-T.

On September 25, 20XX the examiner subsequently received a phone call from Attorney Power of Attorney and preparer of the Form 990. Attorney stated "the organization has property and a building with two floors. One of the floors is rented out to other businesses' to make money for the organization to function".

On October 1, 20XX the examiner received another call from Attorney. He stated "the money was not from rents and he was amending the Form 990 for 20XX-20XX to report the income correctly".

On October 10, 20XX an amended Form 990 was filed for the tax year ending December 31, 20XX and December 31, 20XX and reported the following amounts:

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20XX	Original	Amended
Membership dues	\$0	\$0
Fundraising	0	0
Investment	0	0
Rents	0	0
Sales	0	0

20XX	Original	Amended
Membership dues	0	0
Fundraising	0	0
Investment	0	0
Rents	0	0
Sales	0	0

On December 5, 20XX the organization was contacted and advised the Service was opening up an examination.

On January 15, 20XX IRS Agent spoke with Attorney. He explained the rental income. He stated the 1<sup>st</sup> floor is for members only and the 2<sup>nd</sup> floor gets rented out. The members run the 2<sup>nd</sup> floor dance hall.

On February 8, 20XX the agent received a letter from Attorney. He stated that "the 2<sup>nd</sup> floor is used as a source of revenue for the organization in order to be able to keep the doors open. If the 2<sup>nd</sup> floor is not used for revenues the dues of members would have to be at an amount beyond the members means". "All 2<sup>nd</sup> floor functions are run by members of the organization. The users are ethnic groups or organizations that provide service to the community or to their ethnicities". Also provided was a list of income for the tax year ending in 20XX. It had the breakdown for the first and second floors. Breakdown provided (below):

<b>Income</b>		
1st floor	0	
1st Floor Exp		0
Net Income 1st Floor	-0	
<b>2nd Floor</b>		
Sales	0	
Rents	0	
2nd Floor Income	0	
2nd Floor Expense		0
<b>Net income</b>	0	

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On February 27, 20XX the agent had a phone conversation with Attorney. He stated again that the 2<sup>nd</sup> floor is run by the members. The 2<sup>nd</sup> floor is rented out to ethnic clubs that do salsa dancing. The members run the bar and the door.

On March 14, 20XX, the agent received a letter from Attorney. The letter states "The 2<sup>nd</sup> floor is open everyday to all members but on Friday and Saturdays it's used for special functions for members and their guest", and "The facilities are never open to the general public at any time".

On July 18, 20XX the agent received an email from Attorney. It states that the 2<sup>nd</sup> floor must remain open because it is used to generate income for the organization to help pay expenses because most members are retirees.

On November 18, 20XX, the agent conducted a phone interview with President the organizations President. He stated that the City Salsa Club rents out the 2<sup>nd</sup> floor on Friday and Saturday nights. City Club pays \$0 for rent each night to the organization. He also stated non-members can use the clubs facilities. Some of the services the club provides are a bar, and restaurant. The patrons of the City Salsa Club can go down stairs and get food from the restaurant on the 1<sup>st</sup> floor. The organization provides all the liquor for the City Club.

City Salsa Club's website is <http://www.website.com/>. The website shows the address of the Salsa club as Address. It also shows the Salsa clubs days of operation and the specific genre are shown below:

Salsa Monday Bachata Salsa lesson 8-9pm dance party 10pm to 2am  
Latin Tuesday Bachata Salsa lesson 8-9pm dance party 10pm to 2am  
Salsa Friday Salsa lessons from 9-10pm Dance party 10pm to 2am  
Salsa Saturday Salsa lessons from 9-10pm Dance party 10pm to 2am  
The website says "join us and 300+ dancers this and every week for Friday and Saturday night salsa in location".

ORG has never filed a Form 990-T to report the non-member income.

ORG has over 0% non member income for the tax years ending December 31, 20XX, 20XX and 20XX. The non-member income for each year is shown below:

20XX

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ORG		December 31, 20XX

1st Floor income                    0  
2ndFloor  
Sales                                    0  
Rents                                    0  
2nd Floor Totals                    0  
  
Total Income                         0  
  
Non Member Income %            **0%**  
0/0

**20XX**  
1st Floor Income                    0  
2nd  
Floor  
Sales                                    0  
Rent                                     0  
2nd Floor Total                    0  
  
Total Income                         0  
  
Non Member Income %            **0%**  
0/0

**20XX**  
1st Floor Income                    0  
2nd  
Floor  
Sales                                    0  
Entrance Fees                       0  
2nd Floor Total                    0  
  
Total Income                         0  
  
Non Member Income %            **0%**  
0/0

The percentages of non-member income are summarized as follows:  
December 31, 20XX 0%  
December 31, 20XX 0%  
December 31, 20XX 0%

Law

Form 886A	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
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Section 501(c)(7) of the Code provides exemption for 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 inure to the benefit of any private shareholder.

Section 512(a)(3)(B) of the Code defines the term "*exempt function income*" as the gross income from dues, fees, charges, or similar amounts *paid by members* of the organization as consideration for providing such members or their dependents or guests goods, facilities, or services in furtherance of the purposes constituting the basis for the exemption of the organization to which such income is paid (*emphasis added*).

Public Law 94-568 provides 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. 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. Gross receipts are defined for this purpose as those receipts from normal and usual activities traditionally conducted by clubs of the same general type.

**Regulation 1.501(c)7-1 Income Tax (b)**

(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 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 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.

Revenue Ruling 60-324 1960-2 C.B 173 Use by outside- A social club exempt for Federal income Tax under 501(c)7 may lose its exemption if it makes its club facilities available to the general public on a regular, recurring basis since it may then no longer be considered to be organized and operated exclusively for its exempt purpose.

Revenue Procedure 71-17 gives further guidance. Use of clubs facilities by the general public is significant for two reasons. It may indicate the existence of a nonexempt purpose; or, if not of sufficient substantially to result in the loss of exemption, it may make the club liable for unrelated business income tax. The term "general public" as used in the Revenue Procedure means persons other than members of the club or their dependents or guest.

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Revenue Procedure 71-17 Sec 2.2 states, "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 non-profitable purposes".

Pittsburg Press Club v United States 579 F2d at 761  
Revenue derived from non member is used to benefit members since the outside revenue permits the club to assess lower dues than would otherwise be required to support the clubs facilities and operations.

United States v Fort Worth Club of Fort Worth Texas, 345 F.2d52; Polish American Club, Inc v. Commissioner 33 TCM 925  
Solicitation of the general public to utilize club facilities will disqualify the social club for tax exempt exemption.

#### **.Government's Position**

The organization does not qualify for exemption because it engages in a business which makes its social facilities available to the general public. Revenue Ruling 60-324 states a social club may not be considered tax exempt if it makes its club facilities available to the general public on a regular recurring basis. The City Salsa Club rents the 2<sup>nd</sup> floor of the clubs facilities four days a week. This confirms that the club rents on a recurring and regular basis. The 2<sup>nd</sup> floor is rented on Monday, Tuesday, Friday and Saturday nights from 8:00pm until 2:00 am. During this time the guests of the City Club may go to the 1<sup>st</sup> floor and dine in the club facilities.

The organization itself does not solicit by advertisement. City Salsa Club solicits by advertisement or otherwise for public patronage of the organization's facilities located on the 2<sup>nd</sup> floor. This is evidence that the club is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes as required in Revenue Ruling 1.501(c) 7.

Income test shows for the years of 20XX through 20XX the club has derived 0% to 0% of its income from non member sources. The club exceeds the 15/35% test for the years 20XX, 20XX, and 20XX as set forth by Rev Proc 71-17 and P.L. 94-568.

Non member income is considered any income paid to the organization from anyone who is not a member of the organization.

Revenue derived from non members is used to benefit members since the outside revenue permits the club to assess lower dues than would otherwise be required to



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support the clubs facilities and operations. Pittsburgh Press Club v. United States 579 F.2d at 761.

Based on the facts of the examination, the organization does not continue to qualify for tax exempt status under section 501(c) 7. It is the Government's position that the ORG's tax exempt status should be revoked. The ORG engages in a business which makes its social facilities available to the general public, and has also exceeded the non-member income test for the tax years December 31, 20XX, December 31, 20XX, and December 31, 20XX.

### Tax payer's Position

The organization's Power of Attorney stated that the facilities are never used by the general public and that only members and their guests used the 2<sup>nd</sup> floor area for special engagements on Friday and Saturday nights. However, this is contradicted by other statements made by the President and from evidence obtained from the City Salsa Club's web site as noted in the Facts section.

### Conclusion

As the Club 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) its exempt status under 501(c)(7) of the Internal Revenue Code will be revoked effective January 1, 20XX.

As a taxable entity, the organization is required to file Form 1120, U.S. Corporation Income Tax Return, for all periods after December 31, 20XX.

The ORG is required to pay U. S Corporation Income Tax on all income earned for the years of examination. The tax due is shown below:

Year Ending	12/31/XX	12/31/XX	12/31/XX
1st Floor			
Sales	0	0	0
2nd FI Sales	0	0	0
2nd FI Rent	0	0	0
Expenses	0	0	0
Total Tax Adj	0	0	0
Total Penalty	0	0	0
Total Due	0	0	0

See the attached Form 4549 for the detailed calculations of the tax and penalty breakdown.