

Internal Revenue Service
Tax Exempt and Government Entities Division
Exempt Organizations: Examinations
801 Tom Martin Drive
Room 263
Birmingham, AL 35211

Department of the Treasury

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Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Date: December 10, 2012

Person to Contact ID Number:

UIL Code: 501.07-00

Contact Numbers:

Telephone:

Fax:

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:

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

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

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	
Name of Taxpayer		Year/Period Ended 20XX/ 20XX/20XX

ISSUE

Does _____ continue to qualify for exemption under Internal Revenue Code § 501(c)(7) given that it receives more than 15% of its income from the general public on a recurring basis?

FACTS

_____ is open to the public the following days:

Friday Dance	6pm – 10pm	Year Round
Half & Half	6pm – 10pm	Year Round
Bowling		Year Round

During these times, nonmembers may participate in several of the Club's activities including, but not limited to, the Friday Night Dance, the Half & Half and the Bowling events.

Nonmembers may enter the grounds of the _____ through an entry gate that is unlocked during these hours. In order to participate in these activities, they have only to identify themselves to the employee working the counter in the facility. The counter person then charges them the nonmember fee for participating in these activities.

The _____ is organized and operating as an organization described in Internal Revenue Code § 501(c)(7) to provide social, recreational and other activities to its members. The benefits provided to the members include, but are not limited to, the following activities: the Friday Night Dance, the Half & Half, and bowling events.

The specific and primary purpose of the _____ per its' Articles of Incorporation, is to improve the social climate for its members through recreational, cultural, and charitable activities. The members of this Corporation shall be reputable single persons, including divorced or widowed, of good moral character.

Your organization reported the following sources and amounts of revenue on Forms 990 for periods ending December 31, 20XX, December 31, 20XX and December 31, 20XX

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Club Activities-Nonmember	\$	\$	\$	\$
Membership Dues and Assessments	\$	\$	\$	\$ -
Interest on savings and temporary cash investments	\$	\$	\$	\$ -
Total Nonmember Income	\$	\$	\$	\$
Total Nonmember & Investment Income	\$	\$	\$	\$
Total Income	\$	\$	\$	\$ -
Nonmember % - A/C	\$	\$	\$	\$
Total Nonmember & Investment % - B/C	\$	\$	\$	\$

While reviewing the Income/Expense Statement, Minutes of meetings, your website, as well as other internal documents provided by your organization, such as cash register receipts and Income/Expense Report, it has been noted that your organization is open to the general public on a regular basis, as stated previously. The nonmember income has been recorded in the following accounts within your Income/Expense Report:

Account	Friday Dance Guest
Account	Half & Half
Account	Money Market
Account	Bowling

Based on conducting a two year analysis of gross receipts, it has been noted that the organization received 20.1% and 40.7%, respectively, during tax years ending December 31, 20XX and December 31, 20XX. The gross receipts received by your organization are well over the 15% threshold permitted in Public Law 94-568.

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 not part of the net earnings of which inures to the benefit of any private shareholder."

Section 1.501(c)(7) of the Income Tax Regulations provides that, in general, the exemption extends to social and recreation clubs supported solely by membership fees, dues and assessments. However, a club that engages in a business, such as making its social and recreational facilities open 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).

Prior to its amendment in 1976, IRC § 501(c)(7) required that social clubs be operated exclusively for pleasure, recreation and other non-profitable purposes. Public Law 94-568

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amended the "exclusive" provision to read "substantially" in order to allow an IRC § 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 (Senate Report No. 94-1318 2d Session, 1976-2 C.B. 597) further states;

(a) Within the 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.

(b) Thus, a social club may receive investment income up to the full 35 percent of its gross receipts if no income is derived from non-members' use of club facilities.

(c) In addition, the Committee Report states 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.

Revenue Ruling 66-149 holds a social club as not exempt as an organization described in Internal Revenue Code § 501(c)(7) where it derives a substantial part of its income from non-member sources.

Revenue Procedure 71-17 sets forth the guidelines for determining the effect of gross receipts derived from the general public's use of a social club's facilities on exemption under Internal Revenue Code § 501(c)(7). Where nonmember income from the usage exceeds the standard as outlined in this Revenue procedure, the conclusion reached is that there is a non-exempt purpose and operating in this manner jeopardizes the organization's exempt status.

TAXPAYER'S POSITION

The taxpayer's position is that the only way they are going to be able to operate is to allow nonmembers to participate in member events. The organization has agreed that their exempt status should be revoked.

GOVERNMENT'S POSITION

Your organization has exceeded the 15% non-member threshold on a recurring basis during tax years ending December 31, 20XX and December 31, 20XX and therefore revocation of your organization's exempt status is warranted.

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CONCLUSION

no longer qualifies for exemption under § 501(c)(7) of the Internal Revenue Code as your nonmember income has exceeded the 15% nonmember threshold as outlined in Public Law 94-568. Therefore, your exempt status under § 501(c)(7) of the Internal Revenue Code should be revoked effective January 1, 20XX. Should this revocation be upheld, Form 1120 must be filed starting with tax periods ending December 31, 20XX and December 31, 20XX.

Note: If you are planning to appeal the proposed revocation, please refer to Publication 892 which is enclosed. Appeal should contain statement of facts declared true under penalties of perjury. Please refer to Publication 892, page 3 for example of statement signed under penalties of perjury.