

**Internal Revenue Service**  
Appeals Office

**Department of the Treasury**

**Employer Identification Number:**

Release Number: **201615021**

Release Date: 4/8/2016

Date January 15, 2016

**Person to Contact:**

Employee ID Number:

Tel:

Fax:

**Tax Period(s) Ended:**

**UIL: 0501.07-00**

**Certified Mail**

Dear

We considered your appeal of the adverse action proposed by the Director, Exempt Organizations, Rulings and Agreements. This is our final determination that you do not qualify for exemption from Federal income tax under Internal Revenue Code (the "Code") section 501(a) as an organization described in section 501(c) (7) of the Code.

Our adverse determination was made for the following reason(s):

You had recurring nonmember income exceeding 35% of gross revenue from oil & gas lease, royalties, pipeline, and investment income.

You are required to file Federal income tax returns on Form 1120 for the tax periods stated in the heading of this letter and for all tax years thereafter. File your return with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit [www.irs.gov](http://www.irs.gov).

Please show your employer identification number on all returns you file and in all correspondence with Internal Revenue Service.

We will make this letter and the proposed adverse determination letter available for public inspection under Code section 6110 after deleting certain identifying information. We have provided to you, in a separate mailing, Notice 437, *Notice of Intention to Disclose*. Please review the Notice 437 and the documents attached that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437.

You also 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 tax matters that may not have been resolved through normal channels get prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit [www.irs.gov/advocate](http://www.irs.gov/advocate) for more information.

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

Sincerely Yours,

Acting Appeals Team Manager

Enclosure: Publication 892 and/or 556



Department of the Treasury  
Internal Revenue Service  
P.O. Box 2508  
Cincinnati, OH 45201

Date: 8/3/2015

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

**Legend:**

B = state  
N = date  
P = date  
Q = date  
R = year  
S = year  
T = year  
V = year  
w = percentage  
x = percentage  
y = percentage  
z = percentage

**UIL:**

501.07-03

Dear :

We considered your application for recognition of exemption from federal income tax under Section 501(a) of the Internal Revenue Code (the Code). Based on the information provided, we determined that you don't qualify for exemption under Section 501(c)(7) of the Code. This letter explains the basis for our conclusion. Please keep it for your records.

**Issues**

Do you qualify for exemption under section 501(c)(7) of the Code? No, for the reasons stated below.

**Facts**

You were formed as a corporation in the state of B on P. Although you were formed in R, you did not previously apply for exemption and you were subject to auto revocation as of Q for failure to file Form 990. You submitted a request for reinstatement on N.

Your Articles of Incorporation state that you were formed:

To promote interest in hunting, trap shooting, skeet shooting, rifle shooting, pistol shooting, fishing, bait casting, boating, and other lawful sports, to aid in the protection of fish, birds, and game, and to promote and provide social and athletic recreation for its members; to give and promote entertainments, lectures, social affairs, celebrations, exhibitions, games, amusements of any and all descriptions for the general enjoyment and instruction of the members; to provide shooting matches among its own members and members of other similarly constituted organizations for the benefit, enjoyment, instruction, and well-being of its members; to establish and own shooting galleries and the necessary equipment for them; to purchase or lease, and to maintain and operate buildings, club houses, or other structures as incidental to the above purposes, and to sell, lease, mortgage, or otherwise dispose of the same.

You provide a meeting place and facilities for individuals with common interests in hunting, fishing, trap shooting, boating, and other lawful sports. You also promote the protection of fish, birds, and other wild game and the accompanying grounds. You provide instructional meetings and literature on hunting, fishing and shooting.

Your membership is open to any person having an interest in hunting, fishing, boating, shooting, and the preservation of the same. There is only one class of membership and all members have voting privileges. Your bylaws state that the use of the club grounds and club house are for members and their immediate families only.

Your revenue is from member dues, tavern sales, and royalties from oil and gas rights. In S, y% of your total revenue was from an oil and gas lease. In T, x% of your revenue was from royalties and pipeline revenue and in V, z% of your revenue was from royalties.

#### **Law**

Section 501(c)(7) of the Internal Revenue Code ("Code") provides for exemption from federal income tax 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 inures to the benefit of any private shareholder.

Section 1.501(c)(7)-1(b) of the regulations states that 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). An incidental sale of property will not deprive a club of its exemption.

Revenue Ruling 66-149, 1966-1 C.B. 146, 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 nonmember sources such as, for example, dividends and interest on investments. In this instance, the club's funds were invested primarily for the purpose of producing income through dividends, interest, or capital appreciation. It is evident that 1) such income is regularly derived from nonmember sources, 2) that the income is received in fulfillment of and pursuant to a profit motive, and 3) that the income from investments is substantial in relation to total income.

Revenue Ruling 69-220, 1969-1 C.B. 154, held that a social club that receives a substantial portion of its income from the rental of property and uses such income to defray operating expenses and to improve and expand its facilities is not exempt under section 501(c)(7) of the Code.

Santee Club v. White, 87 F. 2d 5 (1936), held that where a club engages in income producing transactions which are not a part of the club purposes, exemption will not be denied because of incidental, trivial, or non-recurrent activities such as sales of property no longer adapted to club purpose.

National Mah Jongg League v. U.S., 75 F. Supp. 769 (1947), stated that a corporation that was organized for the purpose of promoting the game of Mah Jongg, but income from memberships was insufficient to meet expenses and the corporation engaged in the commercial enterprise of selling to the public lists and tiles, and the income therefrom enabled the corporation to meet its deficit, carry on without an increase of dues or curtailment of operations, and to accumulate a surplus which was donated to charity was not operated exclusively for social purposes or charitable purposes. Therefore, the corporation was not exempt from federal income tax under section 501(c)(7) of the Code or section 501(c)(3) of the Code.

In United States of America v. Fort Worth Club of Fort Worth, Texas, 345 F. 2d 52, 57 (5<sup>th</sup> Cir. 1965), a social club which derived over half of its receipts, in amounts of hundreds of thousands of dollars, from profitable outside business was not exempt from federal income taxes on ground that it was organized and operated exclusively for pleasure, recreation, and other non-profitable purposes. The court declared that for a social club to qualify for exemption under section 501(c)(7) of the Code, its outside profits must be 1) strictly incidental to club activities, not a result of an outside business, and 2) either negligible or non-recurring.

#### **Application of law**

You do not meet the qualifications for exemption under section 501(c)(7) of the Code. Although you were initially formed for pleasure, recreation, and other non-profitable purposes, substantially all of your activities are not for such purposes. You are engaged in leasing oil and gas rights and you receive royalties from this activity which does not fulfill a pleasure, recreation, or other non-profitable purpose.

You are like the organization in Rev. Rul. 66-149 that did not qualify for exemption under section 501(c)(7) of the Code. You regularly derive income from nonmember sources, specifically an oil and gas lease as well as royalties and pipeline revenue. Based on the financial data provided for S-V, the income is regularly derived from these nonmember sources and the income from these sources is substantial in relation to your total income. You are also similar to the organization in Rev. Rul. 69-220 because you receive a substantial portion of your revenue from sources other than your members. Under section 501(c)(7) of the Code, transactions with outsiders should not be a regular source of income.

You are not similar to the organization in Santee Club v. White. Your income from the oil and gas lease and royalties are not incidental or trivial. In addition, they are recurring. For the past several years, you have received a substantial amount of revenue from these sources. Per Section 1.501(c)(7)-1(b) of the regulations, you are engaging in business activities and you are not organized and operated exclusively for pleasure, recreation, and other non-profitable purposes.

You are similar to the organization in National Mah Jongg League v. U.S. The majority of your revenue is from an oil and gas lease and from royalties therefrom. Your income from these sources exceeds the income from your members many times over. The revenue from oil and gas lease and from royalties is recurring and more than incidental. While you may have been organized for pleasure and recreation, your revenue clearly shows that you are not operating for these purposes.

Per United States of America v. Fort Worth Club of Fort Worth, Texas, your royalty income must be incidental to your club activities and either negligible or non-recurring. Instead, your royalty income is both recurring and

substantial. For the years S-V, over w% of your revenue was received from nonmember sources on a recurring basis.

### **Conclusion**

You do not meet the requirements for exemption under section 501(c)(7) of the Code. You receive the majority of your income from nonmember sources on a recurring basis. By leasing oil and gas rights and receiving royalties, you are engaging in a regular trade or business and derive a significant profit from the activity. As a result, you do not operate substantially for pleasure, recreation, or other non-profitable purposes.

### **If you don't agree**

You have a right to file a protest if you don't agree with our proposed adverse determination. To do so, you must send a statement to us within 30 days of the date of this letter. The statement must include:

- Your name, address, employer identification number (EIN), and a daytime phone number
- A copy of this letter highlighting the findings you disagree with
- An explanation of why you disagree, including any supporting documents
- The law or authority, if any, you are relying on
- The signature of an officer, director, trustee, or other official who is authorized to sign for the organization, or your authorized representative
- One of the following declarations:

#### **For an officer, director, trustee, or other official who is authorized to sign for the organization:**

Under penalties of perjury, I declare that I examined this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts and such facts are true, correct, and complete.

#### **For authorized representatives:**

Under penalties of perjury, I declare that I prepared this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts and such facts are true, correct, and complete.

Your representative (attorney, certified public accountant, or other individual enrolled to practice before the IRS) must file a Form 2848, *Power of Attorney and Declaration of Representative*, with us if he or she hasn't already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*.

We'll review your protest statement and decide if you provided a basis for us to reconsider our determination. If so, we'll continue to process your case considering the information you provided. If you haven't provided a basis for reconsideration, we'll forward your case to the Office of Appeals and notify you. You can find more information about the role of the Appeals Office in Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*.

**Where to send your protest**

Please send your protest statement, Form 2848, if needed, and any supporting documents to the applicable address:

U.S. mail:

Internal Revenue Service  
EO Determinations Quality Assurance  
Room 7-008  
P.O. Box 2508  
Cincinnati, OH 45201

Street address for delivery service:

Internal Revenue Service  
EO Determinations Quality Assurance  
550 Main Street, Room 7-008  
Cincinnati, OH 45202

You can also fax your statement and supporting documents to the fax number listed at the top of this letter. If you fax your statement, please contact the person listed at the top of this letter to confirm that he or she received it.

**If you agree**

If you agree with our proposed adverse determination, you don't need to do anything. If we don't hear from you within 30 days, we'll issue a final adverse determination letter. That letter will provide information on your income tax filing requirements.

You can find all forms and publications mentioned in this letter on our website at [www.irs.gov/formspubs](http://www.irs.gov/formspubs). If you have questions, you can contact the person listed at the top of this letter.

Sincerely,

Jeffrey I. Cooper  
Director, Exempt Organizations  
Rulings and Agreements

Enclosure:  
Publication 892