



**DEPARTMENT OF THE TREASURY**

Internal Revenue Service  
TE/GE EO Examinations  
1100 Commerce Street MC 4920 DAL  
Dallas, TX 75424

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Date: JUN 01 2016

Number: **201636045**  
Release Date: 9/2/2016

Person to Contact:  
Identification Number:  
Contact Telephone Number:  
In Reply Refer to:  
EIN:

UIL: 501.07-00

LAST DATE FOR FILING A PETITION  
WITH THE TAX COURT:

CERTIFIED MAIL- Return Receipt Requested

Dear :

This is a Final Adverse Determination Letter as to your exempt status under section 501(c)(7) of the Internal Revenue Code. Your exemption from Federal income tax under section 501(c)(7) of the code is hereby revoked effective June 1, 20XX.

Our adverse determination was made for the following reasons:

You have not demonstrated that your members are bound by a common cause and you are operated exclusively for pleasure and recreation of its members or other non-profitable purposes within the meaning of I.R.C. section 501(c)(7). Organizations described in I.R.C. section 501(c)(7) and exempt under section 501(a) must be organized and operated exclusively for exempt purposes.

You have provided information that your facilities were made available for use of non-members and being operated for profit.

You did not comply with the recordkeeping requirements of Revenue Procedure 71-17 and exceeded the 35% nonmember income for the past four tax periods.

You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the year ending May 31, 20XX and for all years thereafter.

Processing of income tax returns and assessment of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Internal Revenue Code.

If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claim Court or the District Court of the United States for the District of Columbia before the 91<sup>st</sup> day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment.

You also have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers.

You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling, Tel: \_\_\_\_\_, or write:

Local Taxpayer Advocate:  
Taxpayer Advocate Office

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax 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.

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

Sincerely yours,



Margaret Von Lienen  
Director, EO Examinations

Enclosures:  
Publication 892



Department of the Treasury  
Internal Revenue Service  
Tax Exempt and Government Entities  
Exempt Organizations Examinations

Date:  
March 22, 2015  
Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Manager's Name/ID Number:

Manager's Contact Number:

Response due date:

**Certified Mail – Return Receipt Requested**

Dear \_\_\_\_\_ :

**Why you are receiving this letter**

We propose to revoke your status as an organization described in section 501(c)(7) of the Internal Revenue Code (Code). Enclosed is our report of examination explaining the proposed action.

**What you need to do if you agree**

If you agree with our proposal, please sign the enclosed Form 6018, *Consent to Proposed Action – Section 7428*, and return it to the contact person at the address listed above (unless you have already provided us a signed Form 6018). We'll issue a final revocation letter determining that you aren't an organization described in section 501(c)(7).

**If we don't hear from you**

If you don't respond to this proposal within 30 calendar days from the date of this letter, we'll issue a final revocation letter. Failing to respond to this proposal will adversely impact your legal standing to seek a declaratory judgment because you failed to exhaust your administrative remedies.

**Effect of revocation status**

If you receive a final revocation letter, you'll be required to file federal income tax returns for the tax year(s) shown above as well as for subsequent tax years.

**What you need to do if you disagree with the proposed revocation**

If you disagree with our proposed revocation, you may request a meeting or telephone conference with the supervisor of the IRS contact identified in the heading of this letter. You also

may file a protest with the IRS Appeals office by submitting a written request to the contact person at the address listed above within 30 calendar days from the date of this letter. The Appeals office is independent of the Exempt Organizations division and resolves most disputes informally.

For your protest to be valid, it must contain certain specific information including a statement of the facts, the applicable law, and arguments in support of your position. For specific information needed for a valid protest, please refer to page one of the enclosed Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*, and page six of the enclosed Publication 3498, *The Examination Process*. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process. Please note that Fast Track Mediation referred to in Publication 3498 generally doesn't apply after we issue this letter.

You also may request that we refer this matter for technical advice as explained in Publication 892. Please contact the individual identified on the first page of this letter if you are considering requesting technical advice. If we issue a determination letter to you based on a technical advice memorandum issued by the Exempt Organizations Rulings and Agreements office, no further IRS administrative appeal will be available to you.

**Contacting the Taxpayer Advocate Office is a taxpayer right**

You have the right to contact the office of the Taxpayer Advocate. Their assistance isn't a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate can't reverse a legally correct tax determination or extend the time you have (fixed by law) to file a petition in a United States court. They can, however, see that a tax matter that hasn't 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:

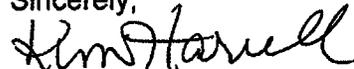
Internal Revenue Service  
Office of the Taxpayer Advocate

**For additional information**

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,



For Paul A. Marmolejo  
Acting Director, EO Examinations

Enclosures:  
Report of Examination  
Form 6018  
Publication 892  
Publication 3498

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

**Issues:**

Does the \_\_\_\_\_ continue to qualify for exemption from Federal income tax under Internal Revenue Code section 501(c)(7)?

**Facts:**

The \_\_\_\_\_ Articles of Incorporation show the \_\_\_\_\_ incorporated on November 8, 19XX in the State of \_\_\_\_\_ (attachment 1). The Second Article provides the purpose is for the \_\_\_\_\_

The \_\_\_\_\_ Bylaws, dated June 20XX, Article I, Section 2 state *the purpose of the shall be self-improvement, mutual help, community work and usefulness to humanity* (attachment 2).

Article II, Membership, Section 1 states *membership shall consist of all \_\_\_\_\_ who have been duly elected and have paid their dues.*

Form 1024, *Application for Recognition of Exemption Under Section 501(a)*, and a Determination Letter do not exist.

Internal Revenue Service (Service) records show the \_\_\_\_\_ is exempt from Federal income tax as an organization described in Code section 501(c)(7).

The \_\_\_\_\_ has a website, \_\_\_\_\_, and the site has tabs; \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_.

The Home tab states the \_\_\_\_\_ is a \_\_\_\_\_ . The tab also provides \_\_\_\_\_ (attachment 3).

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Name of Taxpayer:		Year/Period Ended: May 31, 20XX

The \_\_\_\_\_ tab shows annual membership dues, a listing of the current officers, and a list of projects the \_\_\_\_\_ has been involved with over the years (attachment 4).

The \_\_\_\_\_ tab provides information about \_\_\_\_\_ the (attachment 5).

The \_\_\_\_\_ tab provides information of \_\_\_\_\_ for the 20XX year (attachment 6).

The \_\_\_\_\_ tab provides information about the 20XX (attachment 7).

The \_\_\_\_\_ President stated during the interview that the primary exempt purpose was service to the community, self-improvement, and community luncheons. The \_\_\_\_\_ allows other charitable organizations, such as \_\_\_\_\_, the use of the clubhouse at no cost. The \_\_\_\_\_ allows the local high school to have functions in the clubhouse at no cost. The \_\_\_\_\_ also provides two or three annual scholarships to local high school seniors.

The \_\_\_\_\_ also hosts guest speakers on various subjects and the meetings are open to the public. For an example a representatives from \_\_\_\_\_, an organization dedicated to \_\_\_\_\_, and a police department representative spoke at a meeting. The \_\_\_\_\_ hosts weekly \_\_\_\_\_ classes; the classes are free to members and the general public is charged \$XX. The \_\_\_\_\_ hosts a \_\_\_\_\_; the invites high school girls and their mothers to attend and \_\_\_\_\_ serves them \_\_\_\_\_ and \_\_\_\_\_.

The former President stated the \_\_\_\_\_ also selects a few \_\_\_\_\_ to feature. The \_\_\_\_\_ selects a night, invites the public to visit the \_\_\_\_\_, and the asks for a \$XX donation; one of the \_\_\_\_\_ was featured in the November 20XX edition of \_\_\_\_\_ magazine.

The \_\_\_\_\_ Profit & Loss Statement for the period under examination shows the largest source of income is \_\_\_\_\_ (attachment 8). The \_\_\_\_\_ to members and non-members but did not separate the member from the non-member income. The \_\_\_\_\_ provided XX \_\_\_\_\_ agreements dated from June 6, 20XX to March 23, 20XX; only three agreements identified the renter as a member.

The \_\_\_\_\_ did not maintain records as required by Revenue Ruling 71-17 to separate its member income from its non-member income. The Profit & Loss Statement shows only \_\_\_\_\_ as revenue stream indicative of a \_\_\_\_\_. The \_\_\_\_\_ received \$XX in \_\_\_\_\_, which represents X% of its income and meaning up to XX% of the \_\_\_\_\_ income for the period under examination was from nonmembers.

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The total income and unrelated business income percentage calculated using the last four filed Forms 990EZ, *Short Form Return of Organization Exempt From Income Tax*, and Forms 990T, *Exempt Organization Business Income Tax Return*, shows the Unrelated Business Income (UBI) exceeds 35% for each accounting period.

Period Ending:	05/31/XX	05/31/XX	05/31/XX	05/31/XX
Total Income Per Form 990EZ:	XXXXX	XXXXX	XXXXX	XXXXX
UBI Per 990T:	XXXXX	XXXXX	XXXXX	XXXXX
UBI Percentage:	XX%	XX%	XX%	XX%

**Law:**

**Internal Revenue Code (Code):**

Code section 501 exempts from tax organizations described in Code section 501(c).

Code section 501(c)(7) 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 inures to the benefit of any private shareholder.

**Federal Tax Regulations (Regulations):**

Regulations section 1.501(c)(7)-1(a) addresses social clubs and states in part the exemption provided by Code section 501(a) for organizations described in Code 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 any part of its net earnings inures to the benefit of any 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.

Regulations section 1.501(c)(7)-1(b) states in part 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 Code 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.

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Revenue Procedures:

Revenue Procedure 71-17, 1971-1 C.B. 683, describes the record-keeping requirements for social clubs exempt under Code section 501(c)(7) with respect to nonmember use of their facilities; it sets forth guidelines for determining the effect gross receipts derived by the general public have on a club's exemption from Federal Income Tax under Code section 501(c)(7). Revenue Procedure 71-17 also describes the records a club must maintain when nonmembers use a club's facilities and the circumstances under which a host guest relationship will be assumed, which are relevant both for purposes of determining adherence to the exemption requirements and for computing exempt function income under Code section 512(a)(3).

Section 3 provides a set of assumptions as to the status of nonmembers using club facilities. If nonmember use can be classified into one of the assumptions listed in Revenue Procedure 71-17, then the income derived from these individuals will be income from guests and treated as if from members and therefore be classified as exempt function income. Clubs are required to provide detailed records of nonmember use to substantiate the assumptions.

Section 4 describes the records that a social club must maintain with respect to the assumption listed in section 3. Section 4 also describes the books and records that must be maintained when the assumptions contained in Section 3 do not apply.

Section 4 states that failure to maintain such records or make them available to the Service for inspection will preclude use of the minimum gross receipts standard and audit assumptions set forth in this Revenue Procedure.

Gross Receipts Test/Public Law 94-568:

Section 501(c)(7) was amended in 1976 by Public Law 94-568 to provide that section 501(c)(7) organizations could receive some outside income without losing their exempt status. Senate Report No. 94-1318 (1976), 2d Session, 1976-2 C.B. 597, explains that a social club is permitted to receive up to 35% of its gross receipts, including investment income, from sources outside of its membership without losing its tax-exempt status. It is also intended that within this 35% amount not more than 15% of the gross receipts should be derived from the use of a social club's facilities or services by the general public (nonmembers). In effect, the latter modification increases from 5% (Rev. Proc. 71-17, 1971-1 C.B. 683) to 15% the proportion of gross receipts a club may receive from making its club facilities available to the general public without losing its tax exempt status.

The Senate Report also states that it is not intended that these organizations should be permitted to receive, within the 15% or 35% allowances, income from the active conduct of businesses not traditionally carried on by these organizations. In cases where an

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organization's nontraditional income would cause the organization to exceed the 15% or 35% allowances, consideration should be given as to whether the organization continues to be substantially operated for Code section 501(c)(7) purposes.

According to the Committee Reports, where a club receives income from other sources (non-traditional or unusual), including income from the sale of its clubhouse or similar facility, that income is not to be included in the formula; that is, such income is not to be included in either the numerator or the denominator for purposes of computing the 35% or 15% allowances.

The Committee Reports provide that gross receipts include, charges, admissions, membership fees, dues, assessments, investment income (such as dividends, rents, and similar receipts), and normal recurring capital gains on investments, but excluding initiation fees and capital contributions.

**Taxpayer's Position:**

The Taxpayer agrees with the proposed revocation and executed Form 6018, *Consent to Proposed Action – Section 7428*.

**Government's Position:**

The \_\_\_\_\_ does not qualify as a tax exempt organization described in Code section 501(c)(7) because the \_\_\_\_\_ did not prove its members are bound together by a common objective directed toward pleasure, recreation, or other non-profitable purpose.

The \_\_\_\_\_ advertises availability of its facilities to the general public which is prima facie evidence the \_\_\_\_\_ is engaged in business and is not being operated exclusively for pleasure, recreation, or other social purpose.

The \_\_\_\_\_ also did not comply with record keeping requirements in Revenue Procedure 71-17 and exceeded the 35% nonmember income for the past four accounting periods.

**Conclusion:**

The \_\_\_\_\_ does not continue to qualify for exemption under Code section 501(c)(7).