



**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.22 2017**

Number: **201751022**  
Release Date: 12/22/2017

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

LAST DATE FOR FILING A PETITION  
WITH THE TAX COURT:

**UIL: 501.07-00**

**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 July 1, 20xx.

Our adverse determination was made for the following reasons:

You have not established that you are organized and operated exclusively for pleasure, recreation, and other non-profitable purposes and are not exempt under Internal Revenue Code (IRC) section 501(a) as described under IRC section 501(c)(7).

You have received a substantial portion of your income from leasing oil and gas rights and receives royalties which does not fulfill a non-profitable purpose for s social club as described under IRC section 501(c)(7).

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 June 30, 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.

The Taxpayer Advocate Service (TAS) is an independent organization within the IRS that can help protect your taxpayer rights. We can offer you help if your tax problem is causing a hardship, or you've tried but haven't been able to resolve your problem with the IRS. If you qualify for our assistance, which is always free, we will do everything possible to help you. Visit [taxpayeradvocate.irs.gov](http://taxpayeradvocate.irs.gov) or call 1-877-777-4778.

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

Sincerely yours,

Maria Hooke  
Director, Exempt Organizations Examinations

Enclosures:  
Publication 892



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

Date:  
March 29, 2017  
Taxpayer Identification Number:

Form:

Tax year(s) ended:

Person to contact / ID number:

Contact numbers:  
Phone Number:  
Fax Number:  
Manager's name / ID number:

Manager's contact number:  
Phone 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,

Maria Hooke  
Director, EO Examinations

Enclosures:  
Report of Examination  
Form 6018  
Publication 892  
Publication 3498

Form <b>886-A</b>	U.S. Treasury Department-Internal Revenue Service <b>EXPLANATION OF ITEMS</b>	Schedule No. or Exhibit
Name of Taxpayer		Year/Period Ended June 30, 20xx

**ISSUE:**

Whether ( ) continue to qualify for exemption under IRC Section 501(c)(7) when its investment income consistently exceeds the percent (xx%) limitation of total income?

**FACTS:**

was formed as a corporation in the state of and was granted exemption under IRC 501(c)(7) in March 19xx. The Articles of Incorporation states that was formed for the following purposes: To organize, construct and maintain a club house or lodge; to establish and maintain a hunting and fishing park or preserve; to establish and maintain a golf course and tennis courts and to provide for such other forms of recreation and amusement as the management may deem proper or necessary.

The Form 990 for the tax year ended June 30, 20xx was selected for examination. The Form 990 states that is a providing recreation for its members. provides a meeting place and facilities for individuals with common interests in

During the examination it was noted that membership is based on xx% of the membership accepting the applicant. Membership is also limited to the number of shares available, which is currently xx shares. There is only one class of membership and all members have voting privileges. The bylaws state that the use of the club grounds and cabins are for members, their immediate families and bon-a-fide guests only.

receives its revenue from membership dues, assessments, cabin rentals, and royalties from oil and gas rights. For the tax year ended June 30, 20xx, xx% of the total revenue received was from an oil and gas lease. A review of additional Forms 990 which were not audited shows that for the tax years ended June 30, 20xx and 20xx respectively, xx% and xx% of total revenue received was from royalties.

	6/30/20xx	6/30/20xx	6/30/20xx
Royalties	xx,xxx	xx,xxx	xx,xxx
Total Revenue on F990	xx,xxx	xxx,xxx	xxx,xxx
Percentage of Royalty Income over Total Revenue	xx%	xx%	xx%

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**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(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 nonrecurrent 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.

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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.

**GOVERNMENT'S POSITION:**

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

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

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

is similar to the organization in National Mah Jongg League v. U.S. The majority of its revenue is from an oil and gas lease and from royalties therefrom. 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 may have been organized for pleasure and recreation, the EO's revenue clearly shows that it is not operating for these purposes.

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

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the royalty income is both recurring and substantial. For the tax years ended June 30, 20xx -June 30, 20xx, over xx% of revenue was received from nonmember sources on a recurring basis.

**TAXPAYER POSITION:**

The taxpayer position is unknown at this time.

**CONCLUSION:**

does not meet the requirements for exemption under section 501(c)(7) of the Code. receives the majority of its income from nonmember sources on a recurring basis. By leasing oil and gas rights and receiving royalties, is engaging in a regular trade or business and derive a significant profit from the activity. As a result, does not operate substantially for pleasure recreation, or other non-profitable purposes. We are proposing revocation of the IRC Section 501(c)(7) tax exemption for effective July 1, 20xx.