



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
TEGE EO Examinations Mail Stop 4920 DAL  
1100 Commerce St.  
Dallas, Texas 75242

Date: February 28, 2018

Number: **201829021**  
Release Date: 7/20/2018

Tax Year Ending:

Taxpayer Identification Number:

Person to Contact:

Employee Identification Number:

Employee Telephone Number:

UIL: 501.03-00

CERTIFIED MAIL – RETURN RECEIPT

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

This is a 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 Code section 501(c)(7) effective October 1, 20XX. Your determination letter dated April 12, 19XX is revoked.

The revocation of your exempt status was made for the following reason(s):

Nonmember income received by you exceeded 15% of your total gross receipts and non-exempt function income exceeded 35%. Further, you advertise the use of your facilities to the general public reflecting evidence that that you are engaged in a business and your activities are not substantially all for pleasure and recreation for your members.

Organizations that are not exempt under section 501 generally are required to file federal income tax returns and pay tax, where applicable. For further instructions, forms, and information, please visit [www.irs.gov](http://www.irs.gov).

If you decide to contest this determination, you may file an action for declaratory judgment under the provisions of section 7428 of the Code in one of the following three venues: 1) United States Tax Court, 2) the United States Court of Federal Claims, or 3) the United States District Court for the District of Columbia. A petition or complaint in one of these three courts must be filed within 90 days from the date this determination letter was mailed to you. Please contact the clerk of the

appropriate court for rules and the appropriate forms for filing petitions for declaratory judgment by referring to the enclosed Publication 892. You may write to the courts at the following addresses:

United States Tax Court  
400 Second Street, N.W.  
Washington, D.C. 20217

U.S. Court of Federal Claims  
717 Madison Place, N.W.  
Washington, D.C. 20439

U.S. District Court for the District of Columbia  
333 Constitution Ave., N.W.  
Washington, D.C. 20001

Processing of income tax returns and assessments of any taxes due will not be delayed if you file a petition for declaratory judgment under section 7428 of the Internal Revenue Code.

The Taxpayer Advocate Service (TAS) is an independent organization within the IRS that can help protect your taxpayer rights. TAS 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 TAS assistance, which is always free, TAS will do everything possible to help you. Visit [www.taxpayeradvocate.irs.gov](http://www.taxpayeradvocate.irs.gov) or call 1-877-777-4778.

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,

Maria Hooke  
Director, EO Examinations

Enclosure:  
Publication 892



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

Date:  
May 25, 2017  
Taxpayer Identification Number:  
  
Form:  
  
Tax Year(s) Ended:  
  
Person to Contact / ID Number:  
  
Employee ID:  
Contact numbers:  
Telephone:  
Fax:  
Manager's Name / ID Number:  
  
Employee ID:  
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,

*Denise Gonzalez for*

Maria Hooke  
Director, EO Examinations

Enclosures:  
Report of Examination  
Form 6018  
Publication 892  
Publication 3498

|                         |  |                                       |
|-------------------------|--|---------------------------------------|
| Form <b>886-A</b>       | Department of the Treasury - Internal Revenue Service<br><b>Explanation of Items</b> | Schedule No. or Exhibit               |
| <b>Name of Taxpayer</b> |  | <b>Year/Period Ended</b><br>9/30/20XX |

**ISSUE:**

Whether the \_\_\_\_\_ will continue to qualify as an exempt social club under *IRC section 501(c)(7)*?

**FACTS:**

(the "Club") was granted exemption as a social club exempt from federal income tax under *IRC section 501(c)(7)* pursuant to a ruling issued on April 12, 19XX. According to the Club's Articles of Organization, the Club's purpose is exclusively for pleasure, recreation, and other non-profit purposes within the meaning of *IRC Section 501(c)(7)*, as from time to time amended, including the fostering, encouraging and engaging in athletic activities. The Club's current principal activity is to provide golf facilities and services for the pleasure and recreation of its members, their guests and the public. The Club operates a golf course and a clubhouse that includes a pub and locker facilities with a large parking lot on the grounds. The Club operates seasonally from the first week in April until mid-November. Per the Club's Form 1024, Application for Recognition of Exemption under 501(a), "golf carts both pull and mechanized are provided. The club also fosters an emphasis on junior golf with several neighboring schools ( \_\_\_\_\_ etc.). Several social events (i.e. dances) held during the year further enhance the social climate of the club. An on-site kitchen provides for light snacks and meals for all members."

The Club advertises on its website that it is a \_\_\_\_\_ hole semi-private club. During the operating season, the Club is open to the public on weekdays. On weekends and holidays, non-members must play with a member, as their guest. The Club's signpost, located at the main entrance, states that the public is welcome to play Monday through Friday. The Club's web site advertises that the course is open to the public Monday through Friday and lists the greens fees for golf and carts. Tee times are available by calling the Pro Shop and online booking. The web site indicates that gift certificates, discount golf cards, monthly drawing and other special offers are available by phone or on-line. The discount golf cards include five rounds of golf at a 0% savings. Another option for non-members is a Fairway Freedom Pass available for \$0 and used for greens fees for the cardholder and guest. The Fairway Freedom Pass application states that purchasers must be non-members for at least one season to be eligible for the pass.

The Club's filing requirements include Form 990-T, Exempt Organization Business Income Tax Return, which is due by the 0 day of the 0 month after the end of its tax year. For tax year ending 9/30/20XX, the due date was 2/15/XX. The Club requested an automatic six-month extension of time to file the Form 990-T by 8/15/XX. However, the Club did not file the Form 990-T by the extended due date and did not file it until the examiner requested the delinquent return which was received on 2/21/20XX.

On Form 990-T for its tax year ending 9/30/20XX, the Club incorrectly reported its entire Unrelated Trade or Business Income in Part I on Line 6, Rent Income, including income from the non-member use of the facilities. The Form 990-T Instructions state that a *IRC section 501(c)(7)* social club reports its restaurant and bar receipts from nonmembers on line 1, gross receipts or sales. The 990-T instructions for Schedule C, Rent Income, state that *IRC section 501(c)(7), (9), and (17)* organizations, enter gross rents in Part I, line 6, and applicable

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expenses in Part II, lines 14 through 28 and all rents except those that are exempt function income must be included. The Club's Form 990, Part VIII, Statement of Revenue, also included incorrectly its non-member income on Line 6a, Gross Rents. Inspection of the previous and subsequent fiscal year Forms 990-T revealed that the Club reported nonmember income incorrectly as Rent Income on those Forms also.

During the examination, it was determined that the Club did not comply with the record-keeping requirements of *Revenue Procedure 71-17, 1971-1 C.B. 683 683* which sets forth guidelines for determining the effect of gross receipts derived from use of a social club's facilities by the general public have on the club's exemption under *IRC section 501(c)(7)* and recordkeeping requirements. In order to determine the income received from outside its membership, the examiner requested a breakdown of the 990-T Unrelated Business Income. Exhibit A attached.

The examiner used the financial system's reports including the profit and loss statements to reconcile Forms 990 and 990-T and to determine the income received from outside its membership. The examination revealed that the two additional accounts, Handicap Fees - Non Members and Tee Signs are Non Member income and increases the Non Member gross receipts by \$0. Exhibit B attached.

Based on examination of the Club's Form 990 returns for the period ending September 30, 20XX and review of their books and records, the percentage of gross receipts from nonmember use of facilities exceeded 15% and the percentage of gross receipts from sources outside its membership, including investment income, exceeded 35% of total gross receipts. The following chart illustrates the percentage of gross receipts from non-member and investment income:

| Year/Period Ended  | % of gross receipts from nonmember use | % of gross receipts from investment income | Total % investment income & nonmember income |
|--------------------|--|--|--|
| September 30, 20XX | 0%                                     | 0%   | 0%   |

This analysis indicates that the Club has been consistently using income from nonmembers to support the activities of its members.

**LAW:**

*IRC Section 501(a)* states that an organization described in *subsection (c) or (d)* shall be exempt from taxation under this subtitle unless such exemption is denied under *IRC Section 502* concerning feeder organizations or *IRC Section 503* concerning organization engaged in prohibited transactions.

Organizations exempt from federal taxes as described in *IRC Section 501(c)(7)* include 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.

*Treas. Reg. 1.501(c)(7)-1*, relating to the requirements of exemption of such clubs under *IRC section 501(a)*, reads in part as follows:

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- (a) The exemption provided by *section 501(a)* for organizations described in *section 501(c)(7)* applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, but does not apply to any club if its net earnings inures to the benefit of any private shareholder. In general, this exemption extends to social and recreation clubs that 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 using club facilities or in connection with club activities.
- (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 non-profitable 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.

Prior to its amendment in 1976, *IRC Section 501(c)(7)* required that social clubs be operated exclusively for pleasure, recreation, and other non-profitable purposes. *Public Law 94-568* amended the "exclusive" provision to read "substantially" in order to allow a *section 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* further state:

- (a) Within this 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 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. These percentages supersede those provided in *Revenue Ruling 71-17, 1971-1 C.B. 683*.
- (b) Thus, a social club may receive investment income up to the full 35 percent of its gross receipts if no income is received from non-members' use of club facilities.
- (c) In addition, the Committee Reports state 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.
- (d) The Senate report also indicates that even though gross receipts from the public exceed this standard, it does not necessarily establish that there is a nonexempt purpose. A conclusion that there is a nonexempt purpose will be based on all the facts and circumstances including, but not limited to, the gross receipts factor. If a club exceeds the 15/35% test, then it will maintain its exempt status only if it can show through facts and circumstances that "substantially all" of its activities are for "pleasure, recreation and other non-profitable purposes."



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*IRC Section 6001* states "Every person liable for any tax imposed by this title, or for the collection thereof, shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe. Whenever in the judgment of the Secretary it is necessary, he may require any person, by notice served upon such person or by regulations, to make such returns, render such statements, or keep such records, as the Secretary deems sufficient to show whether or not such person is liable for tax under this title."

*Revenue Ruling 58-589, 1958-2 C.B. 266*, sets forth the criteria for exemption under *IRC section 501(c)(7)*, and provides that a club must have an established membership of individuals, personal contacts, and fellowship. It also provides that, while the regulations indicate that a club may lose its exemption if it makes its facilities available to the public, this does not mean that any dealings with nonmembers will automatically cause a club to lose its exemption. This is particularly true where the receipts from nonmembers are not more than enough to pay their share of the expense. Where, however, a club makes its facilities open to the general public and the purpose is to increase its fund for enlarging its club facilities or for otherwise benefiting its members, it evident that it is not operating as an exempt social club within the meaning of *IRC section 501(c)(7)*. It is equally clear that the solicitation by advertisements or otherwise of public patronage of its facilities may be adverse to its exempt status.

*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 *IRC section 501(c)(7)* if it regularly derives a substantial part of its income from non-member sources. If the income from non-member sources is not incidental, trivial or non-recurrent, then the intent is to produce income and is reflective of a purpose inconsistent with exempt under *IRC section 501(c)(7)*.

*Revenue Ruling 68-119, 1968-1 C.B. 268*, provides that a club will not necessarily lose its exemption if it derives income from transactions with other than bona fide members and their guests, or if the general public on occasion is permitted to participate in its affairs, provided such participation is incidental to and in furtherance of its general club purposes and the income therefrom does not inure to members.

*Revenue Ruling 69-219, 1969-1 C.B. 153*, concerns a club organized for social and recreational purposes. Its principal function is to operate a golf course for its members, who pay annual dues. However, the club regularly holds the golf course open to the public to use upon the payment of an established green fee. Green fees from the public have constituted a significant portion of the club's total receipts from all sources for each of the past five years. The Club used the income from this source to help defray the expense of maintaining and improving the golf course. Based on the facts presented, this golf club does not qualify for exemption under *IRC section 501(c)(7)* because it is engaged in business with the general public by regularly holding its golf course open to the public for use upon payment of established green fees, and the income from this source is inuring to the benefit of the members because it is used for maintenance and the improvement of club facilities.

*Revenue Procedure 71-17, 1971-1 C.B. 683*, sets forth guidelines for determining the effect of gross receipts derived from use of a social club's facilities by the general public have on the club's exemption under *IRC section 501(c)(7)* and recordkeeping requirements. The term

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"general public" as used in this procedure means persons other than members of a club, their dependents or guests. Failure to maintain such records or make them available to the Service for examination will preclude use of the minimum gross receipts standard and audit assumptions set forth in this Revenue Procedure. When a club makes its facilities available to the public to a substantial degree, then the club's activities are not substantially for pleasure, recreation and other non-profitable purposes and operating in this manner jeopardizes the organization's exempt status.

In *Pittsburgh Press Club v. U.S.*, 536 F.2d 572 (3d.Cir. 1976), other facts and circumstances noted by the court to consider in addition to the level of nonmember income include the purposes for which the club's facilities were made available to nonmember groups, the frequency of use of the club facilities by nonmembers, and the amount of net profits derived from the nonmember income.

**TAXPAYER'S POSITION:**

The taxpayer's position is not known at this time.

**GOVERNMENT'S POSITION:**

*IRC Section 501(c)(7)* exempts from taxation clubs organized for pleasure, recreation, and other nonprofit purposes, substantially all of the activities of which are for such purposes and no part of the net earning of which inures to the benefit of a private shareholder. The Club allows regular non-member use of their facilities. The Club uses the income derived from non-members to operate and maintain the facility. Since the Club is not supported solely by the membership dues, fees, and assessments, the non-member income inures to the benefit of the members which is prohibited under *IRC section 501(c)(7)*.

*Treas. Reg. 1.501(c)(7)-1(b)* states: 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 nonprofit purposes, and is not exempt under *IRC section 501(a)*. The Club regularly allows non-members unrestricted use of the facilities. Non-members may golf, rent carts, purchase liquor and/or food from the kitchen and adjacent bar and enjoy full use of the club throughout the operating season.

*Revenue Ruling 58-589, 1958-2 C.B. 266* states that it is equally clear that the solicitation by advertisements or otherwise of public patronage of its facilities may be adverse to a social club's exempt status. The Club's web site advertises that the course is open to the public Monday through Friday and lists the greens fees for golf and carts. The web site indicates that gift certificates, discount golf cards, monthly drawing and other special offers are available by phone or on-line which encourages use of the facility by non-members.

An organization exempt from federal income taxes as described in *IRC section 501(c)(7)* must meet the gross receipts test in order to maintain its exemption. In order to meet the gross receipts test, an organization can receive up to thirty-five percent (35%) of its gross receipts, including investment income, from sources outside its membership without losing its tax-exempt

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status. Within this 35% amount, the use of a social club's facilities or services by non-members cannot be more than fifteen percent (15%) of the social club's gross receipts. *Public Law 94-568*, and the related *Senate Report No. 94-1318, 2d Session, 1976-2 C.B. 597*, states that the exemption of a social club exempt under *IRC section 501(c)(7)* is jeopardized if they receive over 15 percent of their gross income from non-member use of facilities or services. The Club has exceeded the 15% gross receipts standard for nonmember income. Nonmembers use the Club's facilities throughout its operating season and the Club advertises frequently to encourage public use of its facilities. The facts of the case show that the Club is operating in a manner consistent with a for-profit business. In addition, the Club did not exceed the 15% threshold because of a single or unusual event.

As noted in *Pittsburgh Press Club v. U.S.*, 536 F.2d 572 (3d.Cir. 1976), relevant facts and circumstances to consider in determining whether revenues generated from nonmembers are so high as to preclude exemption under § 501(c)(7) include the frequency of use of the club facilities by nonmembers and the purposes of such use and the amount and existence of net profits earned from such use. For the Club, the facts and circumstances indicate that nonmembers use the golf course and other facilities on a regular basis with few restrictions and for the same purposes as members. The Club encourages nonmember use through its advertisements, discounts and special pricing. Inspection of the previous and subsequent fiscal year Forms 990-T revealed that the Club's nonmember income has produced consistent profits.

Based on the large percentage of nonmember income, (0% as noted in the above table), which exceeds the 15% limitation, and the large percentage of non-exempt function income, (0% as noted in the above table) which exceeds the 35% limitation, plus the fact that the Club's facilities are regularly available to the public, it is the Government's position that the Club is no longer operated exclusively for the pleasure and recreation of its members and is not exempt under *IRC section 501(c)(7)*.

**CONCLUSION:**

tax exempt status under *IRC Section 501(c)(7)* should be revoked because nonmember income received by the Club exceeded 15% of the Club's total gross receipts and non-exempt function income exceeded 35%. Further, the Club advertises the use of its facilities to the general public reflecting evidence that the Club is engaged in a business and its activities are not "substantially all for pleasure, recreation or social purposes." no longer meets the requirements to qualify as exempt from federal income tax under *IRC section 501(a)* as described in *IRC section 501(c)(7)*. Therefore, its exempt status under *IRC section 501(c)(7)* will be revoked effective October 1, 20XX. As a taxable entity, the Club is required to file Form 1120, U.S. Corporation Income Tax Return for the periods open under statute, whether or not it has taxable income. Under *IRC section 6501(g)*, these periods include the years ending September 30, 20XX and subsequent tax years. Additionally, the provisions of *IRC section 277* concerning membership organizations that are not exempt organizations apply to the Club's tax reporting on Form 1120.