



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
1100 Commerce Street, MC 4920DAL
Dallas, TX 75242

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Number: **202052047**
Release Date: 12/24/2020

UIL: 501.07-00

Date: August 11, 2020

Taxpayer ID Number:

Form:

For Tax Period(s) Ending:

Person to Contact:

Identification Number:

Telephone Number:

Fax Number:

CERTIFIED MAIL – Return Receipt Requested
LAST DAY FOR FILING A PETITION WITH THE TAX COURT:

Dear ..

This is a final determination that you do not qualify for exemption from federal income tax under Internal Revenue Code (IRC) Section 501(a) as an organization described in IRC Section 501(c)(7) for the tax period(s) above. Your determination letter dated January 31, 19XX is revoked.

Our adverse determination as to your exempt status was made for the following reasons:

IRC § 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. Your activities are not substantially all for pleasure, recreation, and other non-profitable purposes because your non-member income has exceeded the 35%/15% gross receipts limitation on non-member income on a continuing basis for at least three years.

Organizations that are not exempt under IRC 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.

If you decide to contest this determination, you may file an action for declaratory judgment under the provisions of IRC Section 7428 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 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, NW
Washington, DC 20217

U.S. Court of Federal Claims
717 Madison Place, NW
Washington, DC 20439

U. S. District Court for the District of Columbia
333 Constitution Ave., N.W.
Washington, DC 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 IRC Section 7428.

You may be eligible for help from the Taxpayer Advocate Service (TAS). 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 or call 1-877-777- 4778.

Taxpayer Advocate assistance can't be used as substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determination, nor extend the time fixed by law that you have to file a petition in 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 can get any of the forms or publications mentioned in this letter by calling 800-TAX-FORM (800-829-3676) or visiting our website at www.irs.gov/forms-pubs.

If you have questions, you can contact the person listed at the top of this letter.

Sincerely,



Sean E. O'Reilly
Director, EO Examinations

Enclosures:
Publication 892



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

Date:
02/06/2020
Taxpayer ID number:

Form:

Tax periods ended:

Person to contact:

Employee ID number:
Telephone number:
Fax:
Address:

Manager's contact information:

Employee ID number:
Telephone number:
Response due date:

CERTIFIED MAIL – Return Receipt Requested

Dear _____ :

Why you're receiving this letter

We enclosed a copy of our audit report, Form 886-A, Explanation of Items, explaining that we propose to revoke your tax-exempt status as an organization described in Internal Revenue Code (IRC) Section 501 (c)(7).

If you agree

If you haven't already, please sign the enclosed Form 6018, Consent to Proposed Action, and return it to the contact person shown at the top of this letter. We'll issue a final adverse letter determining that you aren't an organization described in IRC Section 501(c)(7) for the periods above.

If you disagree

1. Request a meeting or telephone conference with the manager shown at the top of this letter.
2. Send any information you want us to consider.
3. File a protest with the IRS Appeals Office. If you request a meeting with the manager or send additional information as stated in 1 and 2, above, you'll still be able to file a protest with IRS Appeals Office after the meeting or after we consider the information.

The IRS Appeals Office is independent of the Exempt Organizations division and resolves most disputes informally. If you file a protest, the auditing agent may ask you to sign a consent to extend the period of limitations for assessing tax. This is to allow the IRS Appeals Office enough time to consider your case. For your protest to be valid, it must contain certain specific information, including a statement of the facts, applicable law, and arguments in support of your position. For specific information needed for a valid protest, refer to Publication 892, How to Appeal an IRS Determination on Tax-Exempt Status.

Fast Track Mediation (FTM) referred to in Publication 3498, The Examination Process, generally doesn't apply now that we've issued this letter.

4. Request technical advice from the Office of Associate Chief Counsel (Tax Exempt Government Entities) if you feel the issue hasn't been addressed in published precedent or has been treated inconsistently by the IRS.

If you're considering requesting technical advice, contact the person shown at the top of this letter. If you disagree with the technical advice decision, you will be able to appeal to the IRS Appeals Office, as explained above. A decision made in a technical advice memorandum, however, generally is final and binding on Appeals.

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 adverse determination letter.

Contacting the Taxpayer Advocate Office is a taxpayer right

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 or call 877-777-4778.

Additional information

You can get any of the forms and publications mentioned in this letter by visiting our website at www.irs.gov/forms-pubs or by calling 800-TAX-FORM (800-829-3676).

If you have questions, you can contact the person shown at the top of this letter.

Sincerely,



for Maria Hooke
Director, Exempt Organizations Examinations

Enclosures:

Form 886-A

Form 6018

Form 4621-A Report of Examination

Publication 892

Publication 3498-A

Form 886A	Dep: Internal of the Treasury – Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Period Ended December 31, 20XX

Date of Notice: February 6, 20XX

Issues:

Whether _____ (the organization), is a tax-exempt social club described in section 501(c)(7) of the Code?

Facts:

The _____ is a _____ nonprofit corporation organized on January 21, 19XX. The Organization was issued a determination letter recognizing it as a social club exempt from federal income tax under Internal Revenue Code section 501(c)(7) on January 31, 19XX.

The organization's By-laws, dated as of November 9, 19XX, state its objects (purpose) as:

- To establish and maintain a place for holding meetings,
- To uphold _____ customs and traditions,
- To advance and promote the social and civic interests of its members,
- To encourage athletic exercise and
- To do all things incidental with the purposes permissible under _____ and these purposes shall include the right to apply for a license to sell alcoholic beverages.

The Organization's Form 990-EZ, Part III, Statement of Program Service Accomplishments, line 28 states: "The Association provides a social environment for persons of _____ decent through member participation in traditional events: _____ events."

Based on examination of the organization's Form 990/990T for the period ending December 31, 20XX and review of their books and records, it was determined, that the organization complied with the recordkeeping requirements of Revenue Procedure 71-17, 1971-1 C.B. 683.

However, it was also determined that the organization receives substantial income from outside its membership, 0% percent annually for the audit year, for the rental of the organization's hall and an apartment the organization owed. The organization's books and records were examined for the tax period ending December 31, 20XX.

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The organization correctly filed Form 990-EZ for the tax periods ending December 31, 20XX, December 31, 20XX and December 31, 20XX, reporting the non-member income on line 39b, *Gross receipts, included on line 9, for public use of club facilities*. The organization has a building or hall of its own. The building or hall is available for rent to members and the public.

The following percentages reported for nonmember income are based on the Form(s) 990 and Form(s) 990-T filed by the organization:

A. Year/Period Ended	B. Gross Income (F 990, Line L)	C. Investment Income (F 990, Line 4)	D. Public Use of club facilities (F 990, Line 309b)	E. F 990-T, Sch C, Rent Income, Column b	% of gross receipts from nonmember Income (D/8=)	% of non-member income from public use of club facilities (E/B=I)
December 31, 20XX	\$0	\$0	\$0	\$0	0 %	0 %
December 31, 20XX	\$0	\$0	\$0	\$0	0 %	0 %
December 31, 20XX	\$0	\$0	\$0	\$0	0 %	0 %

The organization has filed Form(s) 990 and Form(s) 990-T for the tax periods ending December 31, 20XX, December 31, 20XX and December 31, 20XX.

The organization has been previously audited for the tax period ending:
 Form 990-T - December 31, 19XX, December 31, 19XX and December 31, 19XX
 Form 990 - December 31, 19XX, December 31, 19XX and December 31, 19XX

The organization provided the closing letter for the audit year ending December 31, 19XX, in their response received on October 30, 20XX. The closing letter for the audit conducted on the Form 990 for the tax period ending December 31, 19XX, states: "Organizations exempt under Section 501 (c)(7) may lose their exempt status if they receive gross receipts from non-member sources (defined as income from passive sources and gross receipts from non-member use of facilities or the sale of goods to non-members) in excess of 35% of total receipts. Also, within this 35% limit, no more than 15% of gross receipts may be derived from non-member use of the club's facilities."

Law:

Organizations exempt from federal taxes as described in Internal Revenue Code (IRC) § 501(c)(7) include clubs organized for pleasure, recreation, and other non-profitable

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purposes, substantially all 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.

Treasury Regulations (Regulation) 1.501(c)(7)-1, relating to the requirements of exemption of such clubs under section 501(a), reads in part as follows:

- (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 inure 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.
- (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 states:

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 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. These percentages supersede those provided in Revenue Ruling 71-17, 1971-1 C.B. 683.

Thus, a social club may receive investment income up to the full 35 percent of its

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gross receipts if no income is received from non-members' use of club facilities.

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.

The Senate report also indicates that even though gross receipts from the general 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.

Revenue Ruling 58-589 sets forth the criteria for exemption under section 501(c)(7) of the Code 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 general public, this does not mean that any dealings with non-members will automatically cause a club to lose its exemption. A club may receive some income from the general public, that is, persons other than members and their bona fide guests, or permit the general public to participate in its affairs, provided that such participation is incidental to and in furtherance of the club's exempt purposes, such dealings with the general public and the receipt of income therefrom does not indicate the existence of a club purpose to make a profit, and the income does not inure to club members.

Revenue Ruling 60-324 provides that a social club that made its social facilities available to the general public through its member-sponsorship arrangement cannot be treated as being operated exclusively for pleasure, recreation, or other nonprofitable purposes and the club no longer qualified for exemption under 501(c)(7) of the Code.

Revenue Ruling 66-149 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 non-member sources such as, for example, dividends and interest on investments.

Revenue Ruling 68-119 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 Procedure 71-17 sets forth guidelines for determining the effect of gross receipts derived from nonmember use of a social club's facilities on exemption under

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Internal Revenue Code Section 501(c)(?) and recordkeeping requirements. 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.

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" for its members.

The following are important facts and circumstances to take into account to determine whether a club may maintain its exemption under IRC 501(c)(?):

- The actual percentage of nonmember receipts and/or investment income.
- Frequency of use of the club facilities or services by nonmembers. An unusual or single event (that is, nonrecurring on a year to year basis) that generates all the nonmember income is viewed more favorably than nonmember income arising from frequent use by nonmembers.
- Record of nonmember use over a period of years. A high percentage in one year by nonmembers, with the other years being within permitted levels, is viewed more favorably than a consistent pattern of exceeding the limits, even by relatively small amounts. (See S. Rept. 94-1318, 2d Sess., 1976-2 C.B. 597,599).
- Purposes for which the club's facilities were made available to nonmembers.
- Whether the nonmember income generates net profits for the organization. Profits derived from nonmembers, unless set aside, subsidize the club's activities for members and result in inurement within the meaning of IRC 501(c)(?).

Organization's Position

Taxpayer's position is that the organization's purpose is "to establish and maintain a place for holding meetings, to advance and promote the social and civic interests of its members; to encourage athletic exercise; and do all things incidental with the purposes permissible under _____ and these purposes shall include the right to apply for a license to sell alcoholic beverages." per the organization's By-laws.

The organization's POA verbally informed the Tax Compliance Officer (TCO) that the organization rents the organization's hall and apartment and does indeed exceed the

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15% limit of public use of the club's facilities. The organization's books and records confirm the above statement.

Per the organization's response received by The Internal Revenue Service on October 30, 20XX, the club rents out its facilities to the public.

The organization's books and records for the examination year, December 31, 20XX, indicates income from non-member income of renting the organization's hall and apartment is 0%.

Government's Position

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 status. Within this 35% amount, not more than fifteen percent (15%) of the gross receipts should be derived from the use of a social club's facilities or provision of services to non-members.

The organization has exceeded the 35%/15% gross receipts limitation on non-member income on a continuous basis for at least three years. Its non-member gross receipts, derived from the rental of the buildings hall and an apartment that are open to both members and non-members, averaged 0 % percent. Per the organization's books and records for the examination year ending December 31, 20XX. The total non-member income from the examination year totals 0% of the organization's gross receipts.

A social club that receives excessive non-member income can only maintain its exemption if it can show that substantially all its activities were for the social and recreational purposes of its members, such as if a high amount of income was received from a single or usual event or the nonmember income limitation was only exceeded in one tax year but not others.

However, there was no one single or unusual event that caused the organization to exceed the 35%/15% threshold. The organization received the non-member income throughout the year from the provision of regular rental of the organization's hall and apartment.

It consistently received 0% of its revenue from non-members over three consecutive tax years based on the Form(s) 990 and Form(s) 990-T filed by the organization.

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Therefore, the organization is not an organization exempt under IRC section 501(c)(7).

Conclusion:

The IRC Section 501(c)(7) tax exempt status of

. should be revoked since its non-member income exceeded the 35%/15% percent limitation on total gross receipts for the year under examination ending December 31, 20XX.

. no longer meets the requirements to qualify as exempt from federal income tax under IRC section 501(a) as described in section 501(c)(7). Accordingly, the organization's exempt status is revoked effective January 1, 20XX.

Form 1120, *U.S. Corporation Income Tax Return*, should be filed for the tax periods after January 1, 20XX.