



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

**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

Number: **202110028**
Release Date: 3/12/2021

UIL: 501.07-00

Date: September 23, 2020

Taxpayer ID Number:

Form:

For Tax Period(s) Ending:

Person to Contact:

Identification Number:

Telephone 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.

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

You have not established that you are operated substantially for pleasure and recreation of its members or other non-profitable purposes and no part of the earnings inures to the benefit of private shareholder within the meaning of IRC Section 501(c)(7). You have made your recreational and social facilities available to the general public. You have exceeded the non-member income test for tax year ending December 31, 20XX.

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 20005

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

Sincerely,

Sean E. O'Reilly
Director, Exempt Organizations Examinations

Enclosures:
Publication 892



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

Date:
04/21/2020
Taxpayer ID number:

Form:

Tax periods ended:

Person to contact:

Manager's contact information:

CERTIFIED MAIL – Return Receipt Requested

Response due date:

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 IRC 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,

Maria Hooke

Director, Exempt Organizations Examinations

Enclosures:

Form 886-A, Form 4621 A,
Form 6018, Pub 892, Pub 3498

Form 886-A (May 2017)	Department of the Treasury – Internal Revenue Service Explanations of Items	Schedule number or exhibit
Name of taxpayer	Tax Identification Number (last 4 digits)	Year/Period ended 20XX

Issues:

- 1) Should () an organization described in IRC § 501(c)(7) be revoked for exceeding investment/nonmember income limitation for all years beginning on or after January 01, 20XX?
- 2) Can the organization utilize the net operating loss (NOL) from rental activity to offset investment income?

Facts:

The () was incorporated in the state of in 19XX. The corporate address is The organization was issued a determination letter dated May 27, 19XX granting exemption under the Internal Revenue Code of 19XX as an organization described in section 501(c)(7). The organization is a membership organization founded to collect, preserve and disseminate genealogical and historic information relating to the origin and spread of the family in America.

Membership in the is open to any person whose ancestor or whose spouse's ancestor was surnamed , or alternate spellings of the name. The conducts the following activities, holds reunions in even-numbered years in , issues a quarterly newsletter and other publications, and sponsors tours of interest to its members. The organization has an active web site, . The organization through its website, sells its products, solicits new membership, allows current members to pay dues, informs members of upcoming events and provides access to its newsletter and publications. In the year of 20XX, the organization sponsored a member tour, The at a cost of \$0. The organization program service revenue was \$0 and the membership dues was \$0.

The organizations primary sources of revenue are program service revenues, membership fees, investment income and rental income.

The organization received investment income from its investments. The organization received rental income from its property located at . The property is the historical home of . The property is rented to . POA stated that the tenant is not a member of the organization.

All rental income and related deductions of the property were reported on form 990T. The organization has reported a net operating loss (NOL) on Form 990T on the rental activity. The organization offset its losses from the rental activity against the earnings from its investments and reported no unrelated business taxable income and no income tax.

Per the organization 20XX Form 990-EZ, the organization reports total revenues of \$0. The organization reported \$0 as program service revenues, \$0 as membership dues and

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assessments, \$0 as sale of merchandise, \$0 as fund raising income, \$0 as other revenue, \$0 as rental income and \$0 as investment income.

For the year of 20XX, the organization reported investment income on form 990 in the amount of \$0, the organization reported \$9 as investment income on form 990T.

As per initial interview with the organizations POA _____, POA stated that the correct amount of investment income was \$0 and the amount reported on Form 990T of \$0 was in error. The investment income was underreported on form 990T for 20XX in the amount of \$0 and underreported on form 990T for 20XX in the amount of \$0.

The investment income and rental income represents 0% of the organization's total revenue for 20XX.

As per Form 990 and Form 990T, the organization has reported the following amounts of investment/nonmember income in 20XX, 20XX, 20XX, 20XX and 20XX.

Investment/Nonmember Income 20XX – 20XX

TABLE DELETED

The _____ has exceeded the 35% investment income/Nonmember limitation for 4 out 5 of the identified years. _____ has also exceeded the nonmember limitation.

Law

Section 501(c)(7) of the Internal Revenue Code (the Code) provides for the exemption from federal income tax for clubs organized for pleasure, recreation, and other nonprofitable 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.

Treasury Regulation Section 1.501(c)(7)-1(a) states that exemption provided by Section 501(a) of the Code for organizations described in Section 501(c)(7) of the Code 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 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 by club facilities or in connection with club activities.

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Treasury Regulation Section 1.501(c)(7)-1(b) 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 nonprofitable purposes, and is not exempt under Section 501(a) of the Code.

Revenue Ruling 58-589, 1958-2 C.B. 266, held that a social club must establish (1) that it is a club both organized and operated exclusively for pleasure, recreation and other non-profitable purposes.

Revenue Ruling 66-149, 1966-1 C.B. 146, held that a social club is not exempt from Federal income tax as an organization described in Section 501(c)(7) of the Internal Revenue Code of 1954 where it regularly derives a substantial part of its income from nonmember sources such as, for example, dividends and interest on investments which it owns.

Public Law 94-568, 1976-2 C.B. 896, provides that a social club may receive up to 35 percent of its gross receipts, including investment income, from sources outside its membership without losing exemption. 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 a club exempt from taxation described in Section 501(c)(7) is to be permitted to 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.

Revenue Procedure 71-17, 1971 WL 26186, 1971-1 C.B. 683 sets forth guidelines for determining the effect gross receipts derived from use of a social club's facilities by the general public have on the club's exemption from federal income tax under section 501(c)(7) of the Code. The club must maintain books and records of each such use and the amount derived therefrom. This requirement applies even though the member pays initially for such use.

Pittsburgh Press Club v. U.S., 536 F.2d 572 (1976); 579 F.2d 751 (1978); and 615 F.2d 600 (1980), the court found that a substantial portion of the club's total gross receipts was from nonmember use of club facilities (determined to be between 11–17% of gross income). This indicated to the court that the club was engaged in business with the general public. Other factors 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.

U.S. v. Fort Worth Club of Fort Worth, Tex., 345 F.2d 52, [a social clubs'] exemption stands on a different footing from that of charitable and educational institutions. There is no basis in the statute or its history for treating unrelated rental income of social clubs differently from any other unrelated club income.

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Coastal Club, Inc., 43 T.C. 783 (1965), the Tax Court held a corporation organized as a duck-hunting club which repeatedly leased its property for the exploration for and the production of oil and gas was not exempt from income tax under section 501(c)(7). The Court noted that the oil and gas lease income exceeded the amounts received from its members in the form of dues and service and guest charges and also supplied more than half of the amounts required and expended for operations, repairs, maintenance, and improvements, the Court felt that if the petitioner were held exempt under the statute, such holding would attribute an intent to Congress that in enacting section 501(c)(7), Congress had not intended.

Taxpayer Position

The taxpayer has not yet been presented with this formal report.

Government Position

Issue #1

The cited Code and Regulations above provide criteria for recognition of a tax-exempt organization under IRC 501(c)(7). Generally, an organization is to be organized and operated exclusively for pleasure, recreation, and other nonprofit purposes. In general, this exemption extends to social and recreation clubs which are supported solely by membership fees, dues, and assessments.

In the case of the organization under examination, it was granted exemption in 19XX, as a social club under IRC 501(c)(7). IRC 501 c 7 organizations are limited to the amount of investment/nonmember income that it can receive and still maintain its exempt status. IRC 501 c 7 organization investment/nonmember income limitation is 35% of the gross revenue received.

In U.S. v. Fort Worth Club of Fort Worth, Tex., 345 F.2d 52, [a social clubs'] There is no basis in the statute or its history for treating unrelated rental income of social clubs differently from any other unrelated club income.

In the year of examination, investment/nonmember income was 0% of the total income received. The facts provided about the organization under examination shows that for the years 20XX – 20XX, the entity received an average of 0% of its revenue from rental and investment income.

The has exceeded the 35% investment income/nonmember limitation for 4 out 5 of the identified years.

The subject organization does not qualify for exemption under IRC 501 C 7.

Conclusion

Based on the above facts and circumstances, and considering the statutory law and rulings cited. The organization has exceeded the 35% investment/nonmember income limitation for 4 out 5

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years. The organization does not qualify for tax-exemption under IRC §501(c)(7) and should be revoked. The proposed date of the revocation is January 1, 20XX.

Form 1120, U.S. Corporation Income Tax Return should be filed for 20XX and thereafter if the organization continues to be subject to income tax.

Issue #2

Can the organization utilize the net operating loss (NOL) from rental activity to offset investment income?

Facts

The organization receives rental income from its residential property located at _____, _____. The organization has shown a net operating loss (NOL) from its rental activities for the last 0 years. The rental income and the NOL have been reported on form 990T. The organization offset its losses from the rental income against the earnings from its investment income and reported no unrelated business taxable income or tax.

For the tax years of 20XX and 20XX, the organization underreported the amount of investment income on form 990T. For 20XX the correct total amount of investment income that should have been reported on form 990T was \$0, the organization reported \$0. For 20XX the correct total amount of investment income that should have been reported on form 990T was \$0, the organization reported \$0.

As per form 990T

Form 990T 20XX, _____ has a loss of \$0 from rental activity and net investment income of \$0, NOL applied \$0, tax liability zero.

Form 990T 20XX, _____ has a loss of \$0 from rental activity and net investment income of \$0, NOL applied \$0, tax liability zero.

Form 990T 20XX, _____ has a loss of \$0 from rental activity and net investment income of \$0, NOL applied \$0, tax liability zero.

Form 990T 20XX, _____ has a loss of \$0 from rental activity and net investment income of \$0, NOL applied \$0, tax liability zero.

Form 990T 20XX, _____ has a loss of \$0 from rental activity and net investment income of \$0, NOL applied \$0, tax liability zero.

Form 886-A (May 2017)	Department of the Treasury – Internal Revenue Service Explanations of Items	Schedule number or exhibit
Name of taxpayer	Tax Identification Number (<i>last 4 digits</i>)	Year/Period ended 20XX

Law

IRC section 501(c)(7) provides exemption from income taxes for “clubs organized for pleasure, recreation, and other nonprofitable 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.”

Regulations §1.501(c)(7)-1(a) further provides that “In general, this exemption extends to social and recreation clubs which are supported solely by membership fees, dues, and assessments

IRC§ 511(a)(1) imposes a tax on the unrelated business taxable income (UBTI) of organizations described in § 501(c).

IRC § 512(a)(3)(A) defines unrelated business taxable income for IRC 501(c)(7) social clubs as gross income excluding any exempt function income, less the deductions allowed that are directly connected with the production of the income.

IRC § 512(a)(3)(B) Exempt function income is defined as “gross income from dues, fees, charges, or similar amounts paid by members of the organization as consideration for providing such members or their dependents or guests goods, facilities, or services in furtherance of the purposes constituting the basis for the exemption of the organization to which such income is paid.”

Rev Rul 81-69, 1981-1 CB 351 addresses the issue of deducting from net investment income the losses incurred on sales to nonmembers. In this ruling, a social club exempt under IRC 501(c)(7) consistently had losses over a period of years from the sale of food and beverages to nonmembers. They also had income from investments undertaken for profit. It was determined that the sales to nonmembers were not profit motivated because of the continuous losses from the activity. As such, the exempt organization could not offset losses from this activity against income from investments which were profit motivated.

Portland Golf Club v. C.I.R., 497 U.S. 154, losses incurred as a result of taxpayer’s sales to nonmembers could be offset against investment income only if nonmember sales were undertaken with intent to profit.

North Ridge Country Club v. Commissioner, 877 F.2d 750 (1989), the Court ruled that a social club “can properly deduct losses from a non-member activity only if it undertakes that activity with the intent to profit, where profit means the production of gains in excess of all direct and indirect costs.

U.S. v. Fort Worth Club of Fort Worth, Tex., 345 F.2d 52, [a social clubs’] exemption stands on a different footing from that of charitable and educational institutions. There is no basis in the statute or its history for treating unrelated rental income of social clubs differently from any other unrelated club income.

Form 886-A (May 2017)	Department of the Treasury – Internal Revenue Service Explanations of Items	Schedule number or exhibit
Name of taxpayer	Tax Identification Number (<i>last 4 digits</i>)	Year/Period ended 20XX

Crile v. C.I.R., T.C. Memo. 2014-202, taxpayer had actual and honest objective of making a profit from her work as artist, despite history of losses and only occasional profits, and thus taxpayer's art activity was trade or business for which she could deduct business expenses.....The Court relying on *Hulter v. Commissioner*, 91 T.C. 371, held that to be entitled to deductions under [IRC §162], the taxpayer must show that she engaged in the activity with an actual and honest objective of making a profit.

The Supreme Court ruled on this issue in the case of *Portland Golf Club v Commissioner of Internal Revenue*, No. 89-530, June 21, 1990 (497 U.S. 154, 110 S.Ct. 2780). The court held that the net loss from the sales to nonmembers was only deductible from the investment income if the nonmember activity was motivated by intent to profit. The nonmember sales activity was determined not to be profit motivated because for eight straight years the club reported losses from its nonmember sales activity.

Taxpayer Position

The taxpayer has not yet been presented with this formal report.

Government Position

In this case, the organization has reported losses via its rental activity in 0 out of the last 0 years. Therefore, there is no intent to profit from the organization's rental activity. Because there is no intent to make a profit, the losses from the rental activity cannot be used to reduce the investment income. **Rev Rul 81-69** stated that intent to profit could not be shown when there were continuous losses from the activity. **Portland Golf Club v Commissioner of Internal Revenue**, The Supreme Court ruled that losses from nonmember sales were only deductible from investment income when there was intent to profit from the activity.

Unrelated business income tax must be paid on the investment income of \$0 for 20XX and \$0 for 20XX less expenses and specific deduction allowed for each year.

Conclusion:

Investment income cannot be offset with losses from an unrelated trade or business that is determined to be not profit motivated. The government concludes that NOL from the rental activity is not profit motivated, as per Portland Court case. Unrelated business income tax must be paid on the investment income of \$0 for 20XX and \$0 for 20XX less expenses and specific deduction allowed for each year.

Form 886-A (May 2017)	Department of the Treasury – Internal Revenue Service Explanations of Items	Schedule number or exhibit
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Family 990T Adjustment			
	20XX		20XX
Investment Income	0		0
Expenses	0		0
Special deduction	0		0
Taxable income	0		0
	0%		0%
Tax	0		0

Alternative Position

Issue

If the proposed revocation of exempt status is not upheld, should the organization be required to pay tax on the investment income and not utilize the NOL to offset the investment income?

Facts

The organization filed form 990 and reported rental income and investment income. The organization filed form 990T and underreported its investment income on form 990T for the years ending 20XX and 20XX.

The rental expenses exceeded the rental income and the organization has reported a NOL. The organization has reported a NOL for zero years on the rental activity. The organization has utilized the NOL from the rental activity to offset the investment income and pay no income tax.

Law

IRC § 511(a)(1) imposes a tax on the unrelated business taxable income (UBTI) of organizations described in § 501(c).

IRC § 512(a)(3)(A) defines unrelated business taxable income for IRC 501(c)(7) social clubs as gross income excluding any exempt function income, less the deductions allowed that are directly connected with the production of the income.

IRC § 512(a)(3)(B) Exempt function income is defined as “gross income from dues, fees, charges, or similar amounts paid by members of the organization as consideration for providing

Form 886-A (May 2017)	Department of the Treasury – Internal Revenue Service Explanations of Items	Schedule number or exhibit
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such members or their dependents or guests goods, facilities, or services in furtherance of the purposes constituting the basis for the exemption of the organization to which such income is paid.”

Rev Rul 81-69, 1981-1 CB 351 addresses the issue of deducting from net investment income the losses incurred on sales to nonmembers. In this ruling, a social club exempt under IRC 501(c)(7) consistently had losses over a period of years from the sale of food and beverages to nonmembers. They also had income from investments undertaken for profit. It was determined that the sales to nonmembers were not profit motivated because of the continuous losses from the activity. As such, the exempt organization could not offset losses from this activity against income from investments which were profit motivated.

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North Ridge Country Club v. Commissioner, 877 F.2d 750 (1989), the Court ruled that a social club “can properly deduct losses from a non-member activity only if it undertakes that activity with the intent to profit, where profit means the production of gains in excess of all direct and indirect costs.

U.S. v. Fort Worth Club of Fort Worth, Tex., 345 F.2d 52, [a social clubs’] exemption stands on a different footing from that of charitable and educational institutions. There is no basis in the statute or its history for treating unrelated rental income of social clubs differently from any other unrelated club income.

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Conclusion

The organization has conducted rental activity for over ten years. The organization has not reported a profit on this activity in over ten years. The organization has utilized the NOL from its

Form 886-A (May 2017)	Department of the Treasury – Internal Revenue Service Explanations of Items	Schedule number or exhibit
Name of taxpayer	Tax Identification Number (<i>last 4 digits</i>)	Year/Period ended 20XX

rental activity to offset the investment income and pay no tax. The rental activity has not showed a profit motive and therefore the losses cannot be used to offset the investment income. The organization shall increase the amount of underreported investment income on form 990T for the years ended December 31, 20XX and December 31, 20XX and pay the appropriated tax after allowed expenses and special deductions.

		Family 990T Adjustment			
		20XX		20XX	
Investment Income			0		0
Expenses		0		0	
Special deduction		0		0	
Taxable income			0		0
		0%		0%	
Tax		0		0	