



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

**Date:**  
January 14, 2022  
**Taxpayer ID number:**

**Form:**

**Tax periods ended:**

**Person to contact:**  
**Name:**  
**ID number:**  
**Telephone:**  
**Fax:**

Release Number: 202245007  
Release Date: 11/11/2022  
UIL CODE: 501.07-00

**CERTIFIED MAIL - RETURN RECEIPT REQUESTED**

**Why we are sending you this letter**

This is a final determination that you don't 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 periods above. Your determination letter dated \_\_\_\_\_ is revoked.

Our adverse determination as to your exempt status was made for the following reasons: You derived \_\_\_\_\_ % of your gross receipts from investment income for the period ended \_\_\_\_\_. This exceeds the \_\_\_\_\_ % limit allowed from all non-member sources.

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](http://www.irs.gov).

**What you must do if you disagree with this determination**

If you want to contest our final determination, you have 90 days from the date this determination letter was mailed to you to file a petition or complaint in one of the three federal courts listed below.

**How to file your action for declaratory judgment**

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.

Please contact the clerk of the appropriate court for rules and the appropriate forms for filing an action for declaratory judgment by referring to the enclosed Publication 892, How to Appeal an IRS Determination on Tax-Exempt Status. 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.

**Information about the IRS Taxpayer Advocate Service**

The IRS office whose phone number appears at the top of the notice can best address and access your tax information and help get you answers. However, you may be eligible for free help from the Taxpayer Advocate Service (TAS) if you can't resolve your tax problem with the IRS, or you believe an IRS procedure just isn't working as it should. TAS is an independent organization within the IRS that helps taxpayers and protects taxpayer rights. Contact your local Taxpayer Advocate Office at:

Or call TAS at 877-777-4778. For more information about TAS and your rights under the Taxpayer Bill of Rights, go to [taxpayeradvocate.irs.gov](http://taxpayeradvocate.irs.gov). Do not send your federal court pleading to the TAS address listed above. Use the applicable federal court address provided earlier in the letter. Contacting TAS does not extend the time to file an action for declaratory judgment.

**Where you can find more information**

Enclosed are Publication 1, Your Rights as a Taxpayer, and Publication 594, The IRS Collection Process, for more comprehensive information.

Find tax forms or publications by visiting [www.irs.gov/forms](http://www.irs.gov/forms) or calling 800-TAX-FORM (800-829-3676).

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

If you prefer to write, use the address shown at the top of this letter. Include your telephone number, the best time to call, and a copy of this letter.

Keep the original letter for your records.

Sincerely,



Sean E. O'Reilly

Director, Exempt Organizations Examinations

**Enclosures:**

Publication 1

Publication 594

Publication 892



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

**Date:**  
08/23/2021  
**Taxpayer ID number:**

**Form:**

**Tax periods ended:**

**Person to contact:**

**Name:**  
**ID number:**  
**Telephone:**  
**Fax:**  
**Address:**

**Manager's contact information:**

**Name:**  
**ID number:**  
**Telephone:**  
**Response due date:**  
09/23/2021

**UNITED PARCEL SERVICE -- Tracking #**

**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.

After we issue the final adverse determination letter, we'll announce that your organization is no longer eligible to receive tax deductible contributions under IRC Section 170.

**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](http://www.taxpayeradvocate.irs.gov) or call 877-777-4778.

**For 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](http://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,

Sean E. O'Reilly  
Director, Exempt Organizations  
Examinations

Enclosures:  
Form 886-A  
Form 6018  
Publication 3498  
Publication 892

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

**ISSUE:**

Whether the organization, tax-  
exempt status under Internal Revenue Code Section 501(c)(7) should be revoked because %  
of total gross receipts is from investment income?

**FACTS:**

The organization, is recognized as a  
section 501(c)(7) social club in a letter from the Internal Revenue Service dated in . It  
was incorporated in the State of as a Domestic Non-Profit on  
the purpose of establishing and operating a social at the .

The organization's Form and Form for the year ended were under  
examination. The primary exempt purpose stated on Form was, "  
The primary unrelated business activity stated on Form was, "Investment Activities of a  
501(c)(7)".

The organization engaged in various activities to increase participation and interest level among  
the chapter's alumni and future alumni.

The organization did not require membership dues. Its sources of financial support solely came  
from dividends and gains from sales of stocks and securities through portfolio investments.

The organization's expenses primarily included investment management fees, payments to  
national organization, member/recreational expenses, and operational expenses. Expenses were  
directly paid from its portfolio investment account.

Per Form for the year ended , the organization reported:

Investment income	\$
Gain from sales of assets other than inventory	\$
Total revenue	\$
Total expenses	\$

Per portfolio investments maintained at for the period from  
to , the organization's investment earnings and total funds spent as  
follows:

Dividends/Income Earned	\$
Realized/Capital Gains	\$
Total Withdrawals	\$

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As presented, investment income reported on the Form matched dividends (slightly different) from portfolio investment summary statement; reported gains from sales agreed with realized gains from sales of investment per statement; total expenses reported on the Form also almost agreed with total withdrawals from investment account.

Based on inspecting prior and subsequent years returns as presented below, the organization incurred a similar receipts and disbursement pattern:

Investment income	\$	\$
Gain from sales of assets other than inventory	\$	\$
Total revenue:	\$	\$
Total expenses:	\$	\$

**LAW:**

**Internal Revenue Code (IRC) Section 501(c)(7)** provides the exemption from federal income tax of 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.

**IRC Section 512(a)(3)(A)**, in relevant part, provides that for certain organizations, including those described in IRC Section 501(c)(7), the term “unrelated business taxable income” means, in part, the gross income (excluding any exempt function income), less the allowable deductions directly connected with the production of the gross income (excluding exempt function income).

**IRC Section 512(a)(3)(B)** defines exempt function income of 501(c)(7) organizations 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.

**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) 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 recreational 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.

Form <b>886-A</b>	Department of the Treasury – Internal Revenue Service <b>Explanations of Items</b>	Schedule number or exhibit
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Prior to its amendment in 1976, IRC Section 501(c)(7) required that social clubs be operated exclusively for pleasure, recreation and other nonprofitable purposes.

**Public Law 94-568** amended the “exclusive” provision to read “‘substantially’ in order to allow an IRC 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** (Senate Report No. 94-1318 2d Session, 1976-2 C.B. 597) further states:

(a) Within the 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.

(b) Thus, a social club may receive investment income up to the full 35 percent of its gross receipts if no income is derived from non-members' use of club facilities.

### TAXPAYER'S POSITION

The organization has until \_\_\_\_\_ to provide their position.

### GOVERNMENT'S POSITION

A social club is allowed to receive investment income up to the full \_\_\_\_\_ % of its gross receipts if no nonmember income is derived from use of club facilities or services.

The organization receives \_\_\_\_\_ % of investment income per return information and portfolio investment records provided. It has clearly exceeded the \_\_\_\_\_ % income threshold permitted in Public Law 94-568.

Consequently, the organization's exempt status under IRC Section 501(c)(7) should be revoked because it does not have any exempt function income and it is fully supported by investment income. The organization does not meet the facts and circumstances exception for the gross receipt test as it regularly receives no member income and consistently earns \_\_\_\_\_ % of total income from portfolio investments per prior and subsequent years returns.

Form <b>886-A</b>	Department of the Treasury – Internal Revenue Service <b>Explanations of Items</b>	Schedule number or exhibit
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**CONCLUSION**

The organization's tax-exempt status under IRC Section 501(c)(7) should be revoked because it receives % of total income from portfolio investments which has failed the full 35% income threshold for a social club. Effective date of revocation should be . Form , U.S. Corporation Income Tax, must be filed for tax periods ending and thereafter. If the revocation is not upheld, the organization is still subject to unrelated business income tax. See alternative position included in this report.

If you agree, please sign and return the enclosed Form 6018.

If you disagree, you can request a managerial telephone conference, submit a statement of your position, send any information you want us to consider, or file a protest with the IRS Appeals Office.

Note: If you are planning to appeal the proposed revocation, please refer to Publication 892 which is enclosed. Appeal should contain statement of facts declared true under penalties of perjury. Please refer to Publication 892, page 2 for example of statement signed under penalties of perjury. We will consider your statement and decide if that information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to Appeals Office.

A response regarding this formal examination report must be received by



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**Alternative Position**

**ISSUE**

If the proposed revocation of exempt status is not upheld, what should be the correct amount of unrelated business income tax (UBIT) for the year under examination?

**FACTS**

As stated previously, the organization, sole source of income is from portfolio investment and all of its expenses are paid directly from the investment account.

The organization filed Form , *Exempt Organization Business Income Tax Return*, for the year under examination. The following shows the amounts reported on its Form :

Investment income	\$
Total expenses	\$
Net	(\$ )
Taxable income	(\$ )

Per portfolio investment summary provided for the period from to

Dividends/earnings	\$
Realized/Capital Gains from sale of investment	\$ _____
Total Income	\$

Investment management fees	\$
Foreign tax withholding	\$
Outside Agent Expense	\$
Member/Recreational/Operational expenses	\$
Total Withdrawals	\$

Based on review of investment summary report, total direct-related investment expenses were \$ (\$ + \$ + \$ 0). Member/Recreational/Operational expenses in the total amount of \$ consisted of fees to national organization, payments for meeting luncheon, accounting fee for returns preparation and the like.

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## LAW

**IRC Section 512(a)(3)(A)**, in relevant part, provides that for certain organizations, including those described in IRC Section 501(c)(7), the term “unrelated business taxable income” means, in part, the gross income (excluding any exempt function income), less the allowable deductions directly connected with the production of the gross income (excluding exempt function income).

**IRC Section 512(a)(3)(B)** defines exempt function income of 501(c)(7) organizations 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.

**Treasury Regulation Section 1.512(a)-1(a)** defines “unrelated business taxable income,” except as otherwise provided in Section 1.512(a)-2, Section 1.512(a)-4, or paragraph (f) of this section, as the gross income derived from any unrelated trade or business regularly carried on, less those deduction allowed by chapter 1 of the Code which are directly connected with the carrying on of unrelated trade or business, subject to certain modifications referred to in Section 1.512(b)-1. ... Except as defined in paragraph (d)(2) of this section, to be “directly connected with” the conduct of unrelated business for purposes of IRC Section 512, an item of deduction must have a proximate and primary relationship to the carrying on of that business.

**Treasury Regulation Section 1.512(a)-1(b)** provides expenses, depreciation, and similar items attributable solely to the conduct of unrelated business activities are proximately and primarily related to that business activity, and therefore qualify for deduction to the extent that they meet the requirements of IRC 162, IRC 167, or other relevant provisions of the Code.

## TAXPAYER’S POSITION

The organization has until \_\_\_\_\_ to provide their position.

## GOVERNMENT’S POSITION

All investment income generated by a social club is treated as unrelated business taxable income and is taxed at general corporate rates.

The organization received dividends from investment and realized gains or capital gains from sale of investment which are all subject to UBIT because they are not generated by members of the organization in performance of IRC 501(c)(7) social and recreational activities. See IRC Section 512(a)(3)(A) for definition of unrelated business taxable income for organizations exempt under

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IRC 501(c)(7). See IRC Section 512(a)(3)(B) for definition of exempt function income of a social club.

The organization had under-reported the investment income on its filed \_\_\_\_\_ which only reported the dividend income. Furthermore, the organization also deducted Member/Recreational/Operational expenses in the total amount of \$ \_\_\_\_\_ which were not directly connected with the production of investment income. See Treasury Regulation Section 1.512(a)-1(a) and (b) for definition of “directly connected with”.

Therefore, the correct amount of total unrelated business taxable income that should be reported on the organization’s Form \_\_\_\_\_ for the year under examination is:

Dividends/earnings	\$	
Realized/Capital Gains from sale of investment	\$	
Total unrelated trade or business income	\$	
Less allowable/direct expenses:		
Investment management fees	\$	
Foreign tax withholding	\$	
Outside Agent Expense	\$	
Total direct-related investment expenses	\$	
Total unrelated business taxable income	\$	
Tax rate – %	X	%
<b>Total unrelated business income tax (UBIT)</b>	<b>\$</b>	

Per above computation, the correct amount of unrelated business income tax (UBIT) for the year under examination should be \$ \_\_\_\_\_.

**CONCLUSION:**

If the proposed revocation of exempt status is not upheld, the correct amount of unrelated business income tax (UBIT) to be reported on the organization’s Form \_\_\_\_\_ for the year ended \_\_\_\_\_ is \$ \_\_\_\_\_. The original Form \_\_\_\_\_ filed by the organization must be adjusted. The organization should pay tax of \$ \_\_\_\_\_ to the **United States Treasury**.