DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
TE/GE EO Examinations, MC 4920 DAL
1100 Commerce Street
Dallas, TX 75242

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

501.07-00

Release Number: **201039036**
Release Date: 10/1/10

LEGEND
ORG = Organization name
XX = Date Address = address

Date: June 22, 2010

Taxpayer Identification Number:
Form:
Tax Year Ended
Person to Contact/ID Number:
Contact Numbers:
Voice:
Fax:

ORG
ADDRESS

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear

In a determination letter dated January 19XX, you were held to be exempt from Federal income tax under section 501(c) (7) of the Internal Revenue Code (the Code).

Based on recent information received, we have determined you have not operated in accordance with the provisions of section 501(c) (7) of the Code. Your nonmember income exceeds the 15% nonmember threshold as outlined in Public Law 94-568 and IRC 501(c)(7). Accordingly, your exemption from Federal income tax is revoked effective January 1, 20XX. This is a final adverse determination letter with regard to your status under section 501(c) (7) of the Code.

We previously provided you a report of examination explaining why we believe revocation of your exempt status is necessary. At that time, we informed you of your right to contact the Taxpayer Advocate, as well as your appeal rights. On February 28, 20XX, you signed Form 6018-A, *Consent to Proposed Action*, agreeing to the revocation of your exempt status under section 501(c)(7) of the Code effective January 1, 20XX.

You have agreed to the change in income tax on Form 1120 for the tax period shown above. For future periods, you are required to file Form 1120 with the appropriate service center indicated in the instructions for the return.

You have the right to contact the Office of the Taxpayer Advocate. Taxpayer Advocate

assistance is not a substitute for established IRS procedures, such as the formal Appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States 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 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:

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

Sincerely,

Nanette M. Downing
Director, EO Examinations

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service
MC:4923CHI
230 S. Dearborn Street Room 1700
Chicago, IL 60604

ORG
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:
Telephone:
Fax:

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear

We have enclosed a copy of our report of examination explaining why we believe an adjustment of your organization's exempt status is necessary.

If you do not agree with our position you may appeal your case. The enclosed Publication 3498, *The Examination Process,* explains how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

If you request a conference, we will forward your written statement of protest to the Appeals Office and they will contact you. For your convenience, an envelope is enclosed.

If you and Appeals do not agree on some or all of the issues after your Appeals conference, or if you do not request an Appeals conference, you may file suit in United States Tax Court, the United States Court of Federal Claims, or United States District Court, after satisfying procedural and jurisdictional requirements as described in Publication 3498.

You may also request that we refer this matter for technical advice as explained in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*. If a determination letter is issued to you based on technical advice, no further administrative appeal is available to you within the IRS on the issue that was the subject of the technical advice.

If you accept our findings, please sign and return the enclosed Form 6018, *Consent to Proposed Adverse Action*. We will then send you a final letter modifying or revoking exempt status. If we do not hear from you within 30 days from the date of this letter, we will process your case on the basis of the recommendations shown in the report of examination and this letter will become final. In that event, you will be required to file Federal income tax returns for the tax period(s) shown above. File these returns with the Ogden Service Center within 60 days from the date of this letter, unless a request for an extension of time is granted. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States 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 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:

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,

Sunita Lough
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Form 6018
Report of Examination
Envelope

LEGEND
ORG = Organization name XX = Date CO-1 = 1st COMPANY

ISSUE:

Does ORG continue to qualify for exemption under Internal Revenue Code § 501(c)(7) given that it receives more than 15% of its income from the general public on a recurring basis?

FACTS:

The ORG (the "ORG") was granted exemption as a social club exempt from Federal income tax under Internal Revenue Code section 501(c)(7). Its purposes as stated in its Articles of Incorporation dated July 17, 19XX are: "the object for which it is formed is to promote social intercourse and athletic sports and to acquire and grounds, club home and appurtenances necessary to these objects."

The ORG's hours of operation are the following days:

Monday	11am- 8pm
Tuesdays	8am – 8pm
Wednesday	8am – 8pm
Thursdays	8am – 8pm
Saturdays	8am – 8pm
Sundays	8am – 8pm

The ORG is normally open April 1st through October 31st; however due to severe flooding, the golf course was only open April 1, 20XX through August 6, 20XX. The ORG house was available for rental for banquets all year round.

The ORG's principal activity is providing facilities and services for the pleasure and recreation of its members and their guests. They operate a restaurant and bar, banquet hall and maintain a golf club. The ORG allows nonmembers to attend their club's facilities and rent the banquet hall for weddings, bridal showers, anniversary parties and other parties.

The ORG allows the CO-1, who is a member of the ORG to conduct an annual football fundraiser. The football fundraiser is open to the public and has been conducted in prior and subsequent years.

During the examination, it was determined that the ORG complied with the record- keeping requirements of Revenue Procedure 71-17, 1971-1 C.B. 683 in regards to the nonmember income generated from the Golf Club and the Banquet Hall; however the organization was not in compliance pertaining to the football fundraiser. In addition, the ORG receives income from outside its membership. Based on examination of the ORG's Form 990 return for the period ending December 31, 20XX and December 31, 20XX and review of their books and records, the

percent of gross receipts from nonmember use of facilities exceeded 15% for the year of the exam as well as for the prior year, while investment income was less than 20% for all years. These receipts are noted in the following chart:

	20XX12	**20XX12**	**TOTAL**	
Club Activities-Member				
Club Activities-NonMember				
Golf Course Income				
Banquet Income				
Food/Liqour Income				
Football Fundraiser				
Total Club Activities-Nonmember				
Membership Dues and Assessments				
Interest on savings and temporary cash investments				
Total Nonmember Income				A
Total Nonmember & Investment Income				B
Total Income				C

Nonmember % - A/C
Total Nonmember & Investment % - B/C

Based on conducting a two year analysis of gross receipts, it has been noted that the organization received 23.3% and 21.8%, during tax years ending December 31, 20XX and December 31, 20XX, respectively. The gross receipts received by your organization are well over the 15% threshold permitted in Public Law 94-568.

Based on the books and records the banquet hall rental represented 64% and 64% of the nonmember income for the years ended December 31, 20XX and December 31, 20XX, respectively. As demonstrated in the following chart:

Year/Period Ended	**Total Nonmember Income**	**Banquet Hall Income**	**% of Banquet Hall Income of Nonmember Income**
12/ 31/20XX			
12/ 31/20XX			

LAW:
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.

Section 1.501(c)(7)-1 of the Income Tax Regulations, 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 inures 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 nonprofitable 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 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.

(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 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 nonmembers 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 there from 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 can not 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 there from 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 Internal Revenue Code Section 501(c)(7) 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 nonprofitable purposes."

The following are important facts and circumstances to take into account to determine whether a club may maintain its exemption under IRC 501(c)(7):

- 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)(7).

TAXPAYER'S POSITION:
The ORG agrees that organization no longer qualifies for exempt status under IRC 501 (c)(7) and will sign the Form 6018.

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 services by non-members.

"ORG" has exceeded the 15% gross receipts standard for nonmember income on a continuous basis for at least three years. The nonmember receipts are earned throughout the year. There was no one single or unusual event that caused the club to exceed the 15% threshold.

ORG's rental of its facility during the year represents 64% of the total of nonmember income, not to mention the nonmember income generated from green fees, cart fees and rider fees. Based on the large percentages of gross nonmember income to total gross receipts of the club, (i.e., 23.3% and 21.8%, as noted in the above table), which exceeds the limitation of 15% as set forth by IRC 501(c)(7) for each of these years, it is the Government's position that the ORG is

no longer operated exclusively for the pleasure and recreation of it's members and is not exempt under section 501(c)(7).

The banquet hall rental alone represented 64% of the nonmember income, which further demonstrates the profit motive.

CONCLUSION:
The IRC Section 501(c)(7) tax exempt status of ORG should be revoked since the nonmember income received by the ORG exceeded 15% of the ORG's total gross receipts for the years under examination. Further, the members were encouraged to inform their family and friends to come and utilize of their facility and they did not have to be accompanied by a member reflecting evidence that the ORG is engaged in a business and is not being "operated exclusively for pleasure, recreation, or social purposes."

ORG no longer qualifies for exemption under § 501(c)(7) of the Internal Revenue Code as your nonmember income has exceeded the 15% nonmember threshold as outlined in Public Law 94-568. Therefore, your exempt status under § 501(c)(7) of the Internal Revenue Code should be revoked effective January 1, 20XX. Should this revocation be upheld, Form 1120 must be filed starting with tax periods ending December 31, 20XX.

Additionally, the organization is reminded of the provisions of IRC 277 concerning membership organizations which are not exempt organizations.

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 3 for example of statement signed under penalties of perjury.